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INTERNAL AUDIT HANDBOOK


VOLUME I

ESTABLISHING AND DEVELOPING AN EFFECTIVE INTERNAL AUDIT FUNCTION

Canada

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INTERNAL AUDIT HANDBOOK

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FOREWORD

Purpose

This Handbook is being developed and maintained through the combined efforts of a number of Working Groups under the general direction of the Interdepartmental Advisory Committee on Internal Audit (IACIA), and specific direction of the Sub-committee for Methodology Development. It replaces the Internal Financial Audit Handbook while building on the foundation provided therein.

The prime motive in the development of this Handbook derives from a recognition by the internal audit community that in attempting to expand the scope of internal auditing within the Government of Canada, from primarily financial to broad-scope auditing as defined in the Standards for Internal Audit in the Government of Canada (Standards), considerable effort was being expended by individual departmental internal audit groups on the development of internal audit handbooks and audit methodology. The IACIA concluded that there would be advantages in a pooling of resources. The result was the formation of the Sub-Committee for Methodology Development and a number of working groups representing both members of the internal audit community and non-audit personnel (functional specialists and line managers). Non-audit personnel provide the technical and functional expertise required for development of guidance for broad-scope auditing. The contents of the three volumes which comprise this Handbook are, and will continue to be, the result of this combined effort.

The purposes for developing and issuing this Internal Audit Handbook may be summarized as follows:

- (a) to communicate the IACIA's suggested principles, concepts, processes, methods and techniques for internal auditing in order to provide useful guidance through which the quality and efficiency of internal audit may be maintained or improved;
- (b) to minimize the duplication of development effort on the part of individual departments in producing internal audit manuals and audit methodology;

- (c) to provide a source of material for both formal and on-the-job training for internal auditors;
- (d) to assist in the implementation of the published Standards;
- (e) to provide mechanisms and criteria through which meaningful performance measurement may be established for internal audit processes, functions and personnel; and
- (f) to provide a base and a repository for evolving internal audit practices considered beneficial to the audit community.

Use

It should be made clear that while the Handbook is the product of joint efforts of knowledgeable individuals, it is not the definitive authority on any subject matter presented. The material was assembled, analysed and written by a representative sample of auditors, managers and specialists. This process is designed to ensure, to the extent possible, that the joint wisdom available in the community has been brought to bear in the development and review of the product. By the time the final version is in place, it will have been reviewed and/or tested in a number of federal government departments and agencies. It should, accordingly, be the best reference available for internal auditing in this environment. Subsequent editions will be prepared based on more recent audit literature and on experience gained through implementation in the federal government environment.

A word of caution may be in order at this time. As described above, very real benefits could result from the judicious use of this Handbook. However, given the generic nature of much of the content and recognizing that the knowledge base for broad-scope internal audit is growing at a considerable rate, much of the material will have to be revised and augmented over time. Accordingly, the user must remember, as befits all handbooks, that:

- (1) this Handbook is intended to be merely a guide and not a substitute for the auditor's judgement, imagination, and initiative;

- (2) as the Handbook is general in nature, often covering material quite broadly because of the need for consistency on a governmental basis, it is essential that each department adapt the material to meet its requirements;
- (3) standard audit procedures cannot be used in a mechanical way, but must be adapted to the needs of the actual situation; and
- (4) standard audit procedures are not a substitute for careful supervisory attention.

Internal audit groups should continue to develop specific material tailored to their unique needs. This Handbook is intended to provide a useful starting point.

Organization

This Handbook consists of three Volumes. Volume I is dedicated to establishing and developing an effective internal audit function. Volume II deals with Internal Audit Concepts and Practices. Volume III is reserved for Internal Audit Guides.

The intent of this organization is two-fold. First, it segregates three major aspects of internal auditing (1) establishing and developing an effective internal audit function; (2) generic internal audit principles and practices; and (3) specific audit guidance. Second, it segregates a large amount of material into more manageable components based on their frequency of use and the varying needs of the anticipated users.

It is our intention to publish Volumes I and II as two complete units, whereas Volume III will be published in the form of individual Guides, as they become available.

Evolution of Internal Audit in the Government of Canada

A brief discussion of the evolution of internal audit in the federal government will provide a more meaningful perspective to such questions as: Where has the function come from? What is its present state? and perhaps most importantly, Where is it going? These questions apply equally from both a departmental and internal audit community viewpoint.

Internal audit, while evolving and developing as a profession, has long been considered an important element in the management control process. The need for this element of control within the federal government was identified as far back as 1962 when the Glassco Commission recommended that departmental management be responsible for establishing and maintaining proper systems of internal audit. In 1966, Treasury Board responded to this recommendation and a policy was published in the Financial Management Guide. In 1973, a number of directives issued in the Guide on Financial Administration, which replaced the earlier Guide, made internal financial audits mandatory for all departments. In 1978, Standards for Internal Financial Audit in the Government of Canada were approved by the Treasury Board and issued by the Office of the Comptroller General. These standards substantially expanded the direction given to internal financial audit groups.

Traditionally, internal audits were confined to assessing the degree of compliance with prescribed financial policies, regulations and other directives. In some departments operational audits were introduced resulting in the expansion of the scope of internal audits. The Auditor General Act enacted in 1977 required the Auditor General to report on cases where there had not been due regard to economy and efficiency and satisfactory procedures had not been established for measuring effectiveness. More recently, a government commitment was made through the Office of the Comptroller General to expand the audit scope, to support and improve the effectiveness of internal auditing and to monitor its development throughout the federal government.

To deal with the shift from primarily financial auditing to the broad-scope auditing covering all departmental operations, the Standards for Internal Financial Audit were replaced in April 1982 by the Standards for Internal Audit in the Government

of Canada. These Standards, purposely forward looking, are intended to provide departmental internal audit functions with the structure on which to build a more effective organization capable of making significant contributions towards improved management practices within their departments.

Internal audit functions are in various stages of development. Effectiveness of the internal audit function is very much dependent on the degree of support from, and participation of, senior management in the audit activities. However, improved organizational arrangements and support, in conjunction with an approved policy from the deputy head are not enough. Better quality audit practices are essential for effective internal auditing. Although departments have made steady and significant progress in a relatively short period of time, much has still to be made. Furthermore, while advancing along the development curve, new and increasingly challenging opportunities will continue to present themselves to internal auditors (e.g. Pre-Implementation Audit). While it is anticipated that the implementation of the existing Standards will foster a higher level of effectiveness for the internal audit function as a whole, it is likely that they too will have to be revised and updated at some later date to reflect future developments and evolving circumstances (e.g. Parliamentary Reform, Access to Information and Reform of the Estimates).

It is the intention here to provide assistance to the audit community in advancing the development of internal auditing in the federal government as an effective management tool.

VOLUME I

**ESTABLISHING AND DEVELOPING AN EFFECTIVE
INTERNAL AUDIT FUNCTION**

Prepared on behalf of

Treasury Board of Canada
Comptroller General
Interdepartmental Advisory Committee
on Internal Audit

Ottawa, Ontario
K1A 1E4

INTERNAL AUDIT HANDBOOK

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INTRODUCTION

Volume I is dedicated to guidance on the establishment and development of an effective internal audit function.

- In Chapter One - The Departmental Internal Audit Policy is discussed in terms of its components. A well-developed internal audit policy, approved and signed by the deputy head and widely promulgated within the department represents internal audit's authority or mandate. It should clearly communicate the roles and responsibilities of everyone involved or connected with the audit process. As circumstances evolve, changes to the internal audit function should be anticipated and the policy should be reviewed and revised accordingly.
- Chapter Two is devoted to a detailed discussion of the audit committee. This is an evolving mechanism. Due to its importance as a source of advice to the deputy head and as a facilitator of internal audit activities, it is felt that it warrants a separate chapter.
- Chapter Three discusses the development of internal audit plans from a function point of view.
- Chapter Four is devoted to discussion of the essential elements of the internal audit group's management process, including responsibility centre planning, implementation and control.

Although a separate chapter is devoted to each of these areas, collectively they form the basis for the infrastructure of internal audit. The degree to which they are developed will have a direct bearing on the effectiveness of internal audit functions.

CHAPTER ONE

THE DEPARTMENTAL INTERNAL AUDIT POLICY

1. OVERVIEW

An Internal Audit Policy, authorized by the deputy head, is the formal pronouncement to departmental management and staff of the establishment of a departmental internal audit function. The policy statement is usually designed to set out the roles, responsibilities and relationships of both the internal audit group and departmental management and staff in the conduct of internal audits. It provides the internal audit group with a "mandate" to conduct internal audits.

The policy by itself should not be construed as a means for getting auditees to accept internal audit findings and recommendations. The best that can be expected is that it will sensitize managers to the potential benefits of internal auditing. The degree of acceptance by auditees, clients or users of internal audits, will be highly dependent on the quality and significance of the auditor's end product, expressed in terms of findings, conclusions, opinions and recommendations.

The Internal Audit Policy establishes the framework within which internal audit operates. It should provide a clear mandate, be authorized by the deputy head and be promulgated throughout the department. The purposes of the internal audit policy are to:

- 1) define the role of internal audit;
- 2) define the scope, operating criteria, and frequency of audits;
- 3) clarify internal and external relationships;
- 4) state the reporting requirements; and
- 5) state the audit response and follow-up requirements.

The following sections of this Chapter provide an indication of what the internal audit policy might cover, for each of the above mentioned headings.

2. ROLE OF INTERNAL AUDIT

The primary role of the internal audit group (per Standard No. 1) is to provide an independent, systematic review and appraisal of all departmental operations for the purpose of advising management as to the economy, efficiency, and effectiveness of internal management policies, practices and controls.

Internal auditing assists the deputy head by either providing assurance that the operations are well managed or by identifying weaknesses in management policies, practices and controls and identifying opportunities for improvement. This is most successfully accomplished through the identification, review and evaluation of the existing control framework against a predetermined control framework for the audited entity.

It is recognized that internal audit can play a number of roles in a department, including coordinator for external audits and that of training ground for aspiring departmental managers. It should be remembered however that these roles are secondary to the one mentioned above. This should be reflected in the policy by including such roles under various other headings in the policy (e.g. external relationships) or by clearly identifying them as secondary roles.

3. SCOPE OF ACTIVITIES

Scope of Audits

Internal auditing should provide senior management with an independent appraisal of all aspects of departmental operations. The internal auditor should assess and express an opinion on:

- a) the design, development and implementation of all significant systems, procedures, processes and controls (including departmentally initiated legislation and those required by central agencies);

- b) the reliability and adequacy of information available for decision-making and accountability purposes;
- c) the extent to which available information is utilized in the decision-making process;
- d) the adequacy of protection afforded public funds and assets; and
- e) the extent of adherence to legislative, central agency and departmental direction.

Also, although departmental internal audit groups have no direct responsibility for evaluation of legislation, policies, procedures, etc., of other departments or central agencies, where they discover weaknesses during the course of auditing, they are expected to bring these to the attention of those responsible.

In summary, the scope of internal audits should be unrestricted within its host departmental or agency boundaries.

Frequency of Audits

The frequency of internal audits depends on a number of varying circumstances. Therefore, no set rules can be established as to the number of times each activity should be reviewed in any given period. However, as a minimum requirement, no major systems, functions and organizational units performing significant responsibilities should go unaudited for more than five years.

Within the above timeframe, the actual frequency of audit for any specific auditable unit will depend upon a number of factors including, but not limited to, materiality, importance to management, degree of risk and opportunity for savings or improvements.

Frequency will be discussed in more detail in Chapter Three - Development of Internal Audit Plans. Its mention in the policy statement informs managers that audits in their areas can be expected at least every five years. It also provides some basis for determination of internal audit resource requirements.

Objectivity and Independence

One of the virtues of an independent audit function is its ability to provide managers with objective feedback and advice regarding the state of their operations. Because of the broadened scope of internal audit, as described above, the pressure on the internal auditor to become and remain knowledgeable of the various operations of the department has increased. Nevertheless, a balance must be struck between the requirement for familiarity and the requirement for independence.

On the one hand, auditors must be free of any bias in connection with the entity they are auditing. They must be impartial and disinterested in the conclusions reached and must express these conclusions honestly and impartially. This is the concept of "objectivity". Not only must the auditor avoid any action or circumstances that could actually impair objectivity but, anything that would give even the appearance of impairment of objectivity must be avoided.

On the other hand, the effectiveness of internal auditors is dependent on both objectivity and knowledge of auditee operations. Therefore internal auditors cannot remain remote from departmental management staff and activities. In fact, it is in an internal auditor's interest to become knowledgeable about departmental operations and to establish and maintain good working relationships and lines of communication within the organization.

To ensure independence, and therefore objectivity, in the internal audit function, the policy should state that internal audit personnel should not be directly involved in developing or implementing departmental policies, systems, procedures or processes. However, to avoid or minimize costly adjustments after new policies, systems, procedures or controls are implemented, the internal audit function should offer constructive advice during the development phase concerning the adequacy of controls, the efficiency where appropriate, and the subsequent auditability of the new or revised activity or system.

To transpose an apt phrase for this situation from a book by Sonja Sinclair¹ on the Office of the Auditor General, - relations between the auditor and the auditee should be "cordial but not cozy".

Authority of an Internal Audit Group

The authority of the internal audit group must be clearly enunciated in the departmental audit policy. This is doubly important given that, with the broadened internal audit activity, many managers will be subjected to an audit for the first time.

The policy should clarify auditor/auditee responsibilities in terms of access to information and staff. It should specify that the auditors are entitled access to all departmental information, records, documents and reports deemed necessary to the fulfilment of their responsibilities. It should also indicate that auditors are entitled to reasonable access to all departmental staff, including management, in order to obtain information and discuss findings relating to their reviews.

In addition, it must be made clear that internal auditing is a staff rather than a line function. **Therefore, internal auditors do not, and should not, exercise direct authority over other activities in the department or agency.**

1 Sonja Sinclair; *Cordial But Not Cosy: A History of the Office of the Auditor General*; McClelland and Stewart; 1979.

4. INTERNAL AND EXTERNAL RELATIONSHIPS

Deputy Head

The organizational status of the internal auditing function and the support accorded to it by the senior management of the department or agency are among the major factors which will determine its effectiveness. Policy statements notwithstanding, the level in the organizational hierarchy at which the internal auditing group is placed, and the officer to whom the head of internal audit reports, determines to a major extent the authority of the internal auditing group. It also discloses to others in the department or agency the degree of commitment senior management has to the nature and scope of the internal auditing role. Without adequate organizational status there are very real limitations regarding access to higher level management officials and the kind of reception accorded to the internal audit groups.

Rather than discouraging flexibility by establishing rigid standards, departments are encouraged to organize in such a manner that their differing requirements can be accommodated. This must be done without impairment of the independence (and hence the effectiveness) of the audit group. It is recognized that a number of factors will be employed in determining the reporting level of the head of the audit group. In this respect a direct reporting relationship to the deputy head is encouraged, however, factors such as the deputy's span of control or the size and nature of the department may make this impracticable. To provide an adequate degree of independence, the head of the internal audit group should report to the deputy head or to another senior executive officer who reports directly to the deputy head.

Independence is enhanced when the head of internal audit reports to an individual with sufficient authority to ensure broad audit coverage, adequate consideration of audit reports and appropriate action on audit recommendations, and breadth of knowledge and experience to provide guidance. If the audit function does not report to the highest practical organizational level there is a danger that auditors will be subjected to internal management pressures which could compromise its independence and thereby diminish its overall effectiveness. Ideally, the head of the internal audit group should be independent of officials who are responsible for operations subject to internal audit. If appropriate reporting relationships are established and

maintained, internal auditors will be able to carry out their work objectively and report their conclusions completely without fear of censure or reprisals.

The internal audit function should be organized in a single group independent of the operations it must review. It should not be subdivided, with separate groups reporting to program managers. There are several reasons for this. A single internal audit group reporting to the deputy head, or to a senior executive officer who reports directly to the deputy head:

- provides advantages of greater independence;
- fosters a broad viewpoint on the interrelationship of organizations and functions within a department or agency; and
- places the internal auditor in a better position to make systematic and independent evaluations of and reports on all departmental programs, activities and operations.

A single audit organization also facilitates the attraction and retention of better managerial and staff capability, more effective staff use, and increased coordination of audit effort and interrelated findings. In addition, under unified direction and supervision, a single audit organization permits the devotion of a greater portion of total staff time to specific audit assignments, and provides greater opportunities for tailoring staff assignments to the talents and experience of staff members.

Some, but not all, of these advantages may be retained by a decentralized audit function with centralized functional direction, and associated review. On the other hand, there can be advantages to decentralization, such as better acceptance and knowledge of the auditee environment, which may compensate for some of the losses.

In summary, the effectiveness of internal audit can be improved and flexibility can be maintained by observing the following:

- the head of the internal audit group reports, where practicable, to the deputy head of the department;
- in all other circumstances, the head of the internal audit group reports to a senior executive officer who reports directly to the deputy head, and who is not responsible for operations subject to internal audit;
- the audit group is not subdivided, with separate groups reporting to program managers; and
- the group conforms to the standards concerning the reporting of findings to the deputy head, regardless of organizational relationships.

Audit Committee

This committee, preferably chaired by the deputy head, is composed of senior executives who assist the deputy head in the effective discharge of his/her responsibilities, in matters relating to the management control framework within the organization.

Due to the significance of this committee's role as it affects internal auditing, and the role it might play for the department in general, a detailed discussion on the audit committee is included in Chapter Two. This information should assist departments in developing their committee's roles and responsibilities, including its relationship with the internal audit group, and to reflect these in the internal audit policy and in the terms of reference for the committee itself.

Departmental Management

In the day to day conduct of its affairs, the internal audit group will be in continuous contact with all levels of management throughout the organization. It should be made clear that the audit function is an advice function and that management retains full responsibility for the operations under review.

The internal auditor is to be held responsible for producing audit plans and carrying out audits resulting in reports which advise management on the state of their operations and on remedial action. Management, in general, should be expected to provide input to audit planning. The deputy head should approve internal audit plans on advice from the audit committee. Responsibility Centre managers should be expected to: work with the auditors such that the audit process is optimized in terms of cost-effectiveness, respond to the findings, conclusions, opinions, and recommendations expressed by auditors in their audit reports, develop action plans based on the audit report recommendations and implement the action plans once they are approved.

Human Resource Development

A role for internal audit, as a service to management, might be in the area of human resource development (management training, interchanges, etc.). As one of the few functions which gets involved in all areas of departmental operations, it is ideal for providing aspiring managers with an opportunity to broaden their perspective and knowledge of the department while acquiring some grounding in management control theory and practices.

Where the department expects to use the internal audit group as a training ground, this intention may be reflected in the internal audit policy, in terms of the respective parts the head of internal audit and managers are expected to play in this process.

Other Departmental Evaluation Groups

To avoid or minimize duplication of effort there should be a regular exchange of information, particularly of plans between the internal audit group and other departmental evaluation and review groups. Where practical, the internal audit group should participate in joint reviews with the other groups to minimize disruption to departmental operations. In any case, the internal audit group should review the operation of these groups, as they would any other control, and rely on their data to the degree warranted.

External Relationships

The internal audit policy should reflect support for the liaison role of the head of internal audit as to dealings with the Office of the Auditor General, the audit/evaluation/review groups from the Audit Branch of the Public Service Commission, the Treasury Board Secretariat and the Office of the Comptroller General. This is done for the purposes of avoiding, or at least minimizing duplication of work and disruption to departmental operations. The internal audit group would also be expected to submit and/or exchange reports, and in some cases working papers with the above agencies.

In addition, the internal audit group should be prepared to respond to requests for its reports and associated records per the new Access to Information Act, and possibly the Privacy Act. (More will be said on this in other parts of the Handbook.)

Finally, mention should be made of the internal audit group's liaison role with professional bodies such as the Institute of Internal Auditors and the Canadian Comprehensive Audit Foundation.

Audit Agents

The policy should reflect at least two ways in which the head of internal audit may be affected by, or involved in, contracting for audit agents.

The first is in contracting for internal audit services. Many departments employ "agents" to conduct some or all of their internal auditing. The Audit Services Bureau of Supply and Services Canada is a major agent of this type. There are also many private sector accounting and consulting firms offering internal audit services.

Departments using agents for internal audit purposes interface with these agents in several different ways. Some departments engage agents to conduct a full internal audit; some supplement the work of an in-house audit group; other departments have all the audit field work done by agents and only have one or more internal staff members who, on a full-time basis, coordinate, analyze and instigate corrective action based on agents' reports. These are all acceptable forms of organization.

Although actual audit work may be assigned to agents, the responsibility for the audit function remains with the department. The department should have a written agreement with the agent which should clearly specify:

- the authority and responsibilities of the auditor,
- the scope of the audit work,
- the reporting relationships,
- the department's right to approve plans and schedules, and
- the treatment of working papers.

Sufficient control over contracting for audit agents should be exercised to assure that the audits proposed and carried out are cost effective.

Reference should be made to Treasury Board's policies on contracting, particularly Chapter 310.

The second involves the head of internal audit in providing advice to management on contracting for audit services (e.g. management reviews, contribution audits, etc.). In such cases the head of internal audit should not assume any direct responsibility. For example, internal audit groups should not be responsible for the establishment of audit criteria or participate in the administrative arrangements for carrying out management reviews or contribution audits of recipients. Otherwise, internal audit would be an element in the management control process related to the particular program, function or operation. It may not therefore be perceived to be objective in assessing that part of the management system at a later date. Consultative advice is to be provided only on an exception basis so that internal audit does not become part of the ongoing administrative and management control structure and process.

5. REPORTING REQUIREMENTS

Assignment Reports

The policy should reflect the following requirements for assignment reports:

- a) the results of each audit assignment should be documented in a formal report;
- b) draft audit reports should be discussed with the officials responsible for the activities being commented upon before being finalized; a response should be obtained and included in the report (method of presentation and location at the option of the department or agency); and
- c) the finalization of audit reports should not be unduly delayed by the response process (i.e. management must endeavour to provide its responses in a timely manner).

The policy should also indicate that:

- a) audit reports should be forwarded to the officials directly responsible for taking corrective action on the matters raised in the report and to their superiors;
- b) where more than one auditee or official is affected, audit reports should be organized in such a way as to make them separable for purposes of presentation to the appropriate auditee;
- c) relevant findings should be made available to the heads of respective functional groups; and
- d) audit reports should be forwarded to the deputy head and the audit committee upon request.

Reports to Deputy Head and Audit Committee

The policy should specify the nature of the reports which should be forwarded to the deputy head and audit committee. The following options should be considered:

- a) forwarding of the executive summary of each assignment report;

- b) provision of periodic reports, tailored to deputy head and audit committee requirements, which summarize significant issues disclosed by audits since the date of the last such report;
- c) provision of periodic accountability reports of progress against planned audit activity which analyse deviations and identify corrective action; and
- d) preparation of an annual report providing the information in (b) and (c).

In considering the above options, it is possible that all of them might be useful. However, the minimum requirement is that a report should be submitted, at least annually, to the deputy head and audit committee setting out the actual audit coverage compared to the annual schedule. It would include appropriate explanations of any significant deviations including any anticipated impact on the long range plan. In addition, the report should summarize the major audit findings and recommendations reported on during the year and comment on the status of corrective actions, as well as any other matters which should be brought to the attention of the deputy head. To be meaningful and informative, the report should be issued in a timely manner. Timeliness in this case would likely be a function of the deputy head or audit committee's requirements and should be included in the policy statement.

Reporting to the audit committee is also discussed in Chapter Two (pages I.2.6 to I.2.9).

6. AUDIT RESPONSE AND FOLLOW-UP REQUIREMENTS

The policy should require that after being provided with a draft assignment report, the manager responsible for taking corrective action should provide a written response to each recommendation within a particular timeframe. The timeframe will vary depending on the department but usually should be within sixty (60) days.

Upon receipt of the final report, the responsible manager should be required to provide the following:

- 1) within a reasonable period of time (e.g. two months) after receipt of the audit report, a plan of action including target implementation dates and the names of officials designated responsible for correcting the deficiencies; and
- 2) periodic progress reports or as otherwise advised by the audit committee, until the corrective action has been taken.

Management is responsible and accountable for the development and implementation of action plans resulting from internal audit activity. Action plans and associated progress reports should be intended for senior managers who would normally oversee and assume ultimate responsibility for ensuring the implementation of corrective actions. Internal audit's interest is in monitoring progress to address identified deficiencies, and to plan for and execute independent follow-up action as directed to do so by the audit committee. These responsibilities, as they affect departmental management staff and internal auditors, should be clearly stated in the internal audit policy.



CHAPTER TWO THE AUDIT COMMITTEE

1. INTRODUCTION

Background

In the private sector, the use of an audit committee of the board of directors to evaluate the accuracy, objectivity and completeness of a company's financial disclosure has become common practice. The functions of such an audit committee are normally related to the company's external reporting, to the work of its external auditors, to corporate governance and often to the work of internal auditors.

In the Government of Canada, the role of the private sector audit committee is, to a large extent, fulfilled by the Public Accounts Committee of Parliament. It regularly reviews the Public Accounts of Canada and deals with any matters brought to its attention by the Auditor General which relate to governance of the federal public sector as a whole or specific departments. However, due to the size and complexity of government operations and the Auditor General's cyclical approach to comprehensive auditing, the Public Accounts Committee does not have many opportunities to deal with the governance of any one department.

In addition, since internal audit in the Government of Canada is a departmental responsibility, the Public Accounts Committee is not charged with maintaining an ongoing relationship with internal audit groups. Rather, departmental audit committees have been advocated by government policy for some time, and more recently by the Auditor General of Canada and the Royal Commission on Financial Management and Accountability.

In recognition of the role departmental audit committees can play in safeguarding the independence of the internal audit function and contributing to departmental governance and accountability, government policy as expressed in the Standards for Internal Audit in the Government of Canada, Standard number 5, is that "There should be an audit committee chaired by the deputy head, composed of executives whose attributes assure the provision of sound and objective counsel to the deputy head."

Purpose of the chapter

The Standards publication provides some guidance on the establishment of audit committees. Flexibility is provided to facilitate the variety of management processes and varying stages of maturity and acceptance of the internal audit function found in departments and agencies.

It is expected that internal auditors will be requested to advise departmental management with regard to the audit committee. This chapter therefore, provides information considered useful to departments and agencies in directing the evolution of their audit committee towards the desired state for the environment in which it operates, and in improving the administrative framework for a smoothly-functioning audit committee. It does not replace the information contained in the Standards publication but rather attempts to expand on that information with regard to what constitutes a model audit committee.

Scope of the chapter

The following major topics will be dealt with in this chapter:

- the role, objectives and responsibilities of audit committees (Section 2);
- the audit committee's terms of reference and working procedures (Section 3); and
- committee size and membership (Section 4).

2. ROLE, OBJECTIVES AND RESPONSIBILITIES OF AUDIT COMMITTEES

Role

The Standards publication defines an audit committee as, "A departmental committee which is normally constituted of the deputy head as chairman and executives whose attributes assure the provision of sound and objective counsel to the deputy head."

The primary role of the audit committee, based on this definition, is clearly one of providing advice and counsel to the deputy head as opposed to the committee having executive authority as a body.

Senior departmental executives, individually and in their corporate role as members of management committees, are responsible for the design and implementation of management practices and controls. These individuals are continually called upon to provide advice to the deputy head on the conduct of the department's operations. They work in an environment where time is of the essence and must respond to imperatives within very tight time and resource constraints. Operational or product requirements focussing on the important aspects of program delivery are quite naturally given the highest priority, often to the detriment of internal control considerations and central agency guidance. The government's approach to internal auditing, providing a strong focus on internal control, has been developed in full awareness of this operating reality.

The ultimate role defined for the audit committee in this scenario is one of "honest broker", weighing program delivery and control considerations against each other and providing advice to the deputy head which strikes a proper balance between the two. The committee's effectiveness will be closely linked to the degree to which it is able to discharge this 'honest broker' role of providing an independent and objective second opinion to the deputy head.

Objectives

In describing the requirement for an audit committee chaired by the deputy head, the Standards specifically avoided the development of a hierarchy of objectives, because it was recognized that the importance of specific objectives will depend on the perception of the deputy head and will vary depending on a department or agency's circumstances.

The Standards did, however, list five broad objectives which are thought to encompass all relevant matters. These are repeated below with some elaboration.

- **to aid the deputy head in fulfilling his responsibilities for the administrative performance of his organization.**

Deputy heads are responsible for planning, implementing and controlling all departmental activities. Since they are not normally directly involved in the day-to-day activities of their departments, they must rely on a flow of relevant information to determine how well the organization is doing in order to provide direction and hold their officials accountable. One source of such information is audit activity.

The audit committee's assistance in analysing and interpreting information on issues raised by auditors, and its advice on action to be taken to deal with them, contributes to the deputy head's ability to make informed decisions.

- **to strengthen the independence of the internal audit function.**

The audit committee bolsters the independence of internal auditors by providing them with a forum for communication with the deputy head and his chosen advisers. Without this avenue of communication, the internal audit function may find it difficult to adhere to findings called for by their professional judgement and to recommend procedures that do not meet with operating management's approval. This should not be interpreted to mean that internal auditors cannot be independent in the absence of an audit committee. However, the existence of an effective audit committee, which can be impartial in dealings between management and the auditor, makes it easier for the auditor to be objective and not unduly influenced by management, particularly if the internal audit head reports to someone other than the deputy head.

Contact with the audit committee also gives the internal auditors increased status and authority which assists the auditor in getting the cooperation required for the audit process to be successful.

- **to emphasize the accountability of managers to government, to Parliament and ultimately to the taxpayer for the effective control and good management of public money.**

The committee can make a substantial contribution towards improved accountability through the thoughtful review and challenge of the management processes which are the subject of audit comments. As part of the process of reviewing audit issues, the committee will determine whether audit recommendations and management responses reflect due consideration for the need to demonstrate value for money in the use of government resources. Where action has not been taken, the committee might wish to hear from the responsible manager to ascertain the reasons for not doing so.

- **to support all efforts to improve management practices and controls.**

Through its role of "honest broker", the audit committee can contribute to improved management practices and controls by providing advice to the deputy head which strikes a proper balance between program delivery and control considerations. The objectivity of an audit committee and the experience of its members are also valuable to the deputy head in identifying areas of concern towards which future audit effort might be directed.

In addition, the advice and support of the audit committee members may prove quite beneficial where issues involve elements of central agency policy and/or activities. In such cases, the views of outside representatives may be seen to be more impartial than a committee made up solely of departmental executives.

- **to provide better communication between senior management, the internal audit function, the Auditor General, and the central agencies.**

The underlying purposes of this objective are to promote effective resolution of audit issues and ensure properly coordinated and cost-effective audit effort within the department, regardless of the source of the audit resources involved.

The audit committee provides a focal point for such communication based on its knowledge of where audit effort is being, has been or will be spent in the department.

Responsibilities

Given the broad objectives just defined, the Standards go on to identify the following major responsibilities which an audit committee may have in advising the deputy head:

- **reviewing the appropriateness of long-term and annual audit plans and the coordination with external audit groups.**

The audit committee should assess the adequacy of the internal audit coverage and its major thrusts prior to the deputy head approving the plan. Its primary focus will be on the underlying rationale that is reflected in the plan proposed by the head of internal audit. In this way the committee can ensure that its concerns, as expressed in previous audit committee meetings, and those of departmental management are properly addressed, and that the overall coverage will be sufficient to enable it to provide appropriate advice to the deputy head. It should also advise the deputy head on the extent of the coverage in terms of the adequacy of the resources assigned to the internal audit function.

In the course of preparing audit plans, the head of internal audit may find it necessary to communicate with the members of the audit committee independently of committee meetings to ensure that their concerns are properly reflected.

Audit committees should also review the coverage proposed by the external auditors and the way in which it interrelates with departmental audit effort to ensure proper coordination of audit effort, to minimize disruption of departmental operations and to reduce the direct cost of audit.

- **discussing major audit reports and findings and identifying how findings in one area may relate to other areas.**
- **considering issues raised by the Auditor General and the central agencies.**
- **monitoring the corrective or preventative action taken on major audit findings.**

The committee's most time consuming responsibility by far will be its consideration of major assessments of departmental activity provided by internal and external auditors. It is in this aspect of its work that the synergy of the group has the greatest potential for assistance to the deputy head. It will be dealing with the highest level review issues and overall assessments that can be provided on the department's internal control framework and its operation.

Audit reporting normally includes management's response to the audit. In addition to assessing the adequacy of these responses, the committee members should also be concerned with providing any insights they may have which would assist management in developing or improving on an action plan to correct the deficiencies.

Given that the committee should rarely be addressing issues that are not of concern to the top and second levels of management, and that the meeting time of the committee will likely be measured in hours, not days, the head of internal audit can provide significant assistance to the committee by judiciously summarizing the audit activities and results into a form more meaningful and manageable for the committee's review. The nature of such summaries will depend largely on the interests of the committee; they could be organized by issue, organizational component, policy, function and perhaps in other ways. One should expect a fair amount of trial and error as the committee strives for a mode of operation which is most productive.

To improve the likelihood of reports being addressed at a level of most interest to the deputy, and thus to the committee, the committee may wish to approve an overall reporting strategy that would be used as the framework for developing the audit plans each year. By planning in this way, audit reports that are outputs from the lowest level audit assignments should be capable of summarization to each level of management in the hierarchy, culminating with the deputy head and the audit committee. Approaching the audit report in this way can save the audit committee valuable time in its deliberations. It is recognized though, that other wide-ranging issues may be identified by the head of internal audit or the committee which will require modification of the reporting scheme during the planning year. Such issues can be dealt with on a meeting-by-meeting basis over the course of the year.

Under the committee operation envisaged here, the head of internal audit would be expected to provide regular accountability reporting of actual progress against an approved plan, as well as issue oriented reporting based on the expectations the committee had from the prior approval of the audit plan. With this level of reporting to the deputy head, the significance of annual reports is greatly reduced. Therefore, the deputy head and the committee may wish to provide direction to the head of internal audit on the requirements for a formal internal audit report for external use, after considering the needs of other potential users such as the Public Accounts Committee, the Auditor General and central agencies.

Part of the committee's workload will be dealing with reports of external auditors, ideally using a process similar to that used for internal audit reports. In the interests of effective committee operation, the head of internal audit should attempt to ensure that these groups communicate with the committee in a manner similar to that established for the internal audit function.

Having dealt with the audit reports, the committee should be advised when an action plan they had seen and assumed would be implemented does not, in fact, proceed as expected. Their interest is not in tasking but rather in their "need to know" the status of the departmental operating environment in order to assess the reasonableness of issues being addressed in the audit plan, and to weigh recommendations and action plans which result from audit activity.

Once an action plan is approved by senior management, the onus is on the line manager to ensure that action is taken. There remains for the internal auditor the responsibility to assess whether appropriate management follow-up action has been taken on audit recommendations (including those of external auditors) and to report on the progress against plans. Through these reports the internal auditor plays a major role in ensuring the committee's ability to assess management's long-term response to recommendations.

The committee will also wish to determine whether or not departmental management or other personnel gave full cooperation to the auditors. In this way, the committee can satisfy itself that no barriers were put in the way of the auditing process and the corresponding results. This point will also be of interest to them in fulfilling

their responsibilities, as discussed on the next page, related to the internal audit function's independence and its evaluation.

It should also be remembered that the head of internal audit must ensure that matters of particular sensitivity or urgency are brought to the attention of the deputy head without delay. The deputy head may then decide whether to refer these matters to his or her audit committee as soon as they are detected or at the next scheduled meeting.

Normally an audit committee would also have the following responsibilities:

- **maximizing internal audit independence**

This is one of the overriding responsibilities of an audit committee, and of particular interest to others, such as central agency policy groups and the Auditor General, who are placing reliance on internal audit group assessments with regards to their own interests in the departments. The committee may periodically review the organizational status of the internal audit function to ensure that the head of internal audit has direct access to the deputy head and the committee. This responsibility is particularly important where the internal audit function might not have a direct reporting relationship to the deputy head.

- **evaluating the internal audit function**

The audit committee may periodically assist or advise the deputy head in evaluating the performance of the internal audit function and perhaps its senior staff.

This would normally consist of their judgement of the internal audit function's utility based on an assessment of:

- the plans and reports presented to it by internal audit and the meaningful changes in management practices and controls resulting from internal audit activity;

- the manner in which internal audit personnel dealt with the audit committee and departmental management and other personnel;
- consideration of reports on the quality of the internal audit function prepared by the Office of the Auditor General and the Office of the Comptroller General; and
- an awareness of the perceptions of the internal audit function held by departmental management, including the degree of cooperation received by the internal audit function in performing its audits.

As was the case with the audit committee's objectives, specific responsibilities will vary depending on a department or agency's circumstances. The preceeding discussion was provided to assist departments and agencies in formulating committee responsibilities most suitable to their own situation.

3. THE AUDIT COMMITTEE'S TERMS OF REFERENCE AND WORKING PROCEDURES

Terms of reference

The use of formal terms of reference which describe the committee's role, objectives, responsibilities and authority is especially desirable for the audit committee because:

- they are instrumental in clearly establishing the roles and relationships of the key parties, (i.e. the audit committee, management, internal auditors and external auditors) involved in the performance and monitoring of the department's management practices and controls;
- they give the committee a solid basis for exercising its influence; and,
- they are another sign to outsiders (i.e. the general public, Parliament and central agencies) that the deputy head is playing an active and responsible role in ensuring that the department's management practices and controls are under continuous examination and that needed improvements are being made.

The ultimate responsibility for approving and promulgating the audit committee's terms of reference belongs to the deputy head. However, the head of the internal audit function would likely be allowed or expected to play a large part in their development.

In addition to the Committee's role, objectives and responsibilities discussed in subsection 2, terms of reference would normally address the following topics:

- authority
- frequency of meetings
- meeting agenda
- minutes of meetings
- who attends meetings
- committee secretary
- special assistance, and
- reporting requirements.

Authority

Particular attention should be paid to ensuring that management's and the audit committee's authority are clearly delineated. The terms of reference should clearly show that only departmental management has the authority to implement changes in management practices and controls. The audit committee's authority is normally restricted to that required to enable it to conduct its business (i.e. acquiring sufficient information to enable it to properly analyse the audit issues before it and provide advice to the deputy head).

Frequency of meetings

The actual number of audit committee meetings held each year will vary with the department's size, complexity, state of operations, the corresponding level of audit activity and the responsibilities of the committee.

The committee meetings may be regularly scheduled or they may be called on an ad hoc basis. There is a certain desirable discipline imposed by a schedule of

meetings, a discipline that would likely work to the advantage of the internal audit function by ensuring that audit matters would not have a tendency to be deferred in favour of other management priorities. It is therefore probably most desirable to schedule a minimum number of meetings annually, based on an anticipated normal workload.

It is possible that one meeting each year will suffice for smaller departments or agencies. Where the department and the corresponding audit effort is small (e.g. the Auditor General's attest audit which is normally completed in July or August and one internal audit contracted out every 3 to 5 years), the audit committee may be able to review both the audit plans of the various auditors and the results of audits in one meeting.

Meeting agenda

To the extent that meeting schedules are set in advance, it may be desirable to predetermine agenda items for each meeting, particularly since much of the audit activity is forecasted in plans. The level of agenda detail that can be provided in advance will be proportional to the degree to which the audit plans can be synchronized with the audit committee's report review process.

The written agenda, besides ensuring more effective use of committee time, can serve as evidence that the committee was thorough and timely in carrying out its responsibilities and that matters discussed were in keeping with its role.

Minutes of meetings

The minutes of audit committee meetings can range from a verbatim transcript of everything that happens at the meetings to simply highlights or major recommendations of the committee members.

Although the exact form and content of minutes are a matter of departmental preference, minutes containing less information than attendance, issues raised, information received and subjects discussed, along with the conclusions of the committee and its recommendations to the deputy head are not likely to properly

document the committee's deliberations, the results of its efforts to deal with issues before it and its conclusions. Well documented minutes serve as evidence of the committee's activity and conclusions for those groups external to the department who wish to know if they can place reliance on the department's management processes. In the absence of formal minutes, the requirement for personal interviews with committee members may be unnecessarily excessive and create an overburden on them.

Who attends meetings

In addition to auditors, internal and external, anyone who can provide information to the committee in order to assist it in its assessment of the issues before it, could be invited to attend audit committee meetings.

Departmental managers should be invited to attend meetings during discussion of any items on the agenda for which they are responsible to allow the committee to evaluate their responses and underlying rationale for proposed corrective action.

It is considered important that the committee reserve the right to meet with these people or groups alone so that matters can be discussed candidly and that sensitive issues can be broached in an atmosphere of confidentiality.

It may also be necessary to request senior officials from central agencies such as the Public Service Commission, the Treasury Board Secretariat and the Office of the Comptroller General, to attend audit committee meetings to clarify policy direction and provide advice on management or audit issues.

Committee secretary

The predominant practice in the Government of Canada is to have the head of internal audit serve as the committee secretary. This has been particularly desirable to ensure that the internal auditor attends all committee meetings and is in a position to act as an adviser and provide staff support to the committee. However, a committee member or another departmental official may be appointed secretary.

Besides keeping minutes of meetings and also handling committee correspondence, the secretary, whether or not a committee member, can be influential in committee matters. He or she works closely with the committee chairperson and will likely be one of the people who has a say in drawing up the agenda. In addition, the secretary should provide research assistance by organizing material to make it as useful to the committee as possible, help formulate lines of inquiry and follow up on administrative matters.

Special assistance

Audit committees may require other assistance in carrying out their responsibilities. This assistance can take varying forms including a budget to engage outside experts where the committee feels independent advice is necessary to interpret or further investigate audit issues and to explain methods used to acquire or analyse data. The head of internal audit should, however, be in a position to provide most of the technical assistance required.

Reporting requirements

Given that the audit committee is an advisory committee to the deputy, it must ensure that he or she receives its advice.

As mentioned earlier, the minutes should be prepared promptly to ensure timely reporting to the deputy and provide evidence of the advice provided, should the deputy head require it in dealing with outsiders. The deputy head may in turn provide copies of the minutes to senior executives or a management committee to assist them in improving action plans in cases where audit committee members have provided advice on their implementation.

Since the audit committee is overlayed on an existing management process, one which likely includes a management committee mechanism for tasking and monitoring projects, care is required by the audit committee secretary to ensure that the results of management committee activities which deal with audit are communicated to the audit committee. This is normally accomplished by regular contact between the secretaries of the two committees.

4. COMMITTEE SIZE AND MEMBERSHIP

Qualifications for membership on an audit committee

The following excerpt from the Standards for Internal Audit in the Government of Canada describes the overall attributes for audit committee membership:

"To meet their responsibilities, audit committee members must possess an understanding of the department's or agency's mandate, its operations, its internal audit, its accounting and financial controls, the accounting and financial reporting principles of the federal government, and the overall government policies and environment within which departments and agencies operate.

The most important attributes which an audit committee member must have are broad experience, open-mindedness and good judgment. An audit committee member must also have the personal independence of spirit to ask the questions that need to be asked, whatever his or her professional background may be. In addition, the audit committee member must be prepared to make reasonable commitments of time and accept important responsibilities."

In effect, the audit committee members collectively should provide a balance between knowledge of department and government operations and objectivity.

The basic grasp of departmental activities, such as might be expected of a person serving on a corporate board of directors, is normally enough to enable a member to contribute effectively as an audit committee member. On the other hand, every committee should have in its membership some solid expertise in government operations and particularly departmental operations. One person who has a solid governmental and departmental background may be enough.

More valuable than knowledge and experience are the personal qualities of the members. The expected attitude would be an insistence on finding out what the facts are rather than relying passively on information as it is presented by the auditors or by management representatives. A committee member must also be

prepared to take issue with the auditor or management if he or she believes that a proposal will not be in the best overall interests of the department, the government as a whole or the general public.

The chairperson

It is only natural that a deputy head should chair his or her own advisory committee. This creates the ideal situation as the deputy head is then in direct control of the quality and quantity of advice received. This in turn increases the probability of a smoothly functioning committee by eliminating speculation as to the wants and needs of the deputy head.

Alternatively, where a department or agency has a senior executive (such as an associate deputy minister, senior assistant deputy minister or vice-chairperson), the deputy head might appoint such an individual as chairperson of the audit committee. Such individuals would normally directly assist the deputy head in the management of the department as a whole and could therefore be expected to provide the same perspective of the department or agency as would be expected of the deputy head. They should therefore, through periodic consultation and feedback from the deputy head, be in a position to guide the audit committee towards the quality and quantity of advice required by the deputy head.

To provide for situations where the chairperson is unable to participate in an audit committee meeting, the deputy head should select a vice-chairperson when he or she establishes the committee or changes its membership. Alternatively, he or she may choose a method of selection such as the committee members choosing their own vice-chairperson.

Departmental expertise

As mentioned earlier, every committee should have at least one person as a member who has a solid governmental and departmental background. In practice, it will likely be necessary to have two members who provide such expertise: one providing program knowledge, the other providing knowledge of administrative policies and practices.

The involvement of departmental managers on the committee is almost certain to increase the effectiveness of the committee by helping it gain the full cooperation, involvement and support of management. Such involvement might also reduce possible misunderstanding and conflicts between management, committee members and the auditors.

Departmental representatives would be expected to provide the expertise required regarding the department's or agency's mandate, its operations, its management practices and controls, the accounting and financial reporting principles of the federal government and the overall government policies and environment.

Bearing in mind the pace of change in the financial, administrative, regulatory and even legislative arenas in recent years, it would not be realistic to expect audit committee members to be true experts in all these areas. Rather, the audit committee would be expected to call upon other departmental managers and representatives of central agencies to provide information and advice during the course of its deliberations.

Departmental representatives will make a significant contribution to the soundness of advice provided to the deputy, based on their knowledge of the environment in which the department or agency operates. However, the very strength that enables them to be strong contributors to committee deliberations, namely their insiders' view of departmental operations, often poses difficulties for them in trying to extract themselves from a situation so as to look at it more objectively. The difficulty is to have departmental managers who are far enough removed from the day-to-day operating decisions to make committee objectivity goals achievable, while still ensuring the individuals can provide the necessary expertise of the departmental operations.

Outside representation

Should the deputy head wish to have even greater objectivity, this might be accomplished by appointing an outside representative (i.e. an individual who is not an employee of the department or agency).

Government representation

A representative from another government department or agency might not be totally familiar with departmental activities, but his or her knowledge of the overall government policies and environment and experience within his or her department could contribute to the soundness of advice while increasing the objectivity of such advice.

Such representatives would normally be senior managers having considerable administrative responsibilities (e.g. ADM Finance and Administration or Departmental Comptroller) so that they might bring to the committee the greatest breadth of knowledge and experience in the area of government-wide policies. Where the deputy head feels that the committee already possesses sufficient technical knowledge, a fellow deputy head possessing overall knowledge of policies and a thorough knowledge of the environment may be requested to become a committee member.

External representation

Senior executives from the private sector could be expected to provide additional benefits to the deputy head in terms of relating private sector experiences as well as providing a visibly impartial and objective viewpoint. The clearly impartial review provided by external representatives (those external to the government) should increase the confidence that groups external to the department (such as the general public, parliamentarians and central agencies) have in the departmental administration. Where the views of the department and a central agency differ, the department could benefit from an external representative's unbiased viewpoint.

The Standards state that "Direction on the introduction of private sector representation into departmental audit committees will await the results of selected trials and the formalization of guidance on the selection and appointment of candidates." Since the trials have not yet been conducted, this guidance is not available. Departments and agencies are encouraged to recruit external representatives on their own. The Internal Audit and Special Studies Division of the Office of the Comptroller General is prepared to respond to any requests for advice on such appointments.

Term of appointment and rotation of members

The following reasons have been offered for rotating audit committee members on a regular basis:

- it spreads the burden of time involved in serving on the committee;
- it ensures that fresh thinking will be introduced periodically, so that new questions will be asked and new issues will be raised;
- it fosters objectivity of the committee whose members may in time identify with particular management personnel or problems, or with policies endorsed or even initiated by the committee;
- service on a departmental audit committee is a valuable experience for departmental and outside representatives alike; a regular rotation policy gives more people a chance to benefit from this experience; and
- with regard to external representatives, more private sector executives will have an appreciation of the problems associated with running a government department or agency.

Rotation should not however be taken to mean a completely new committee every year. Rather, one or two members might be brought into the committee each year to replace members who are stepping down.

Due to the complexities associated with audit committee membership, a minimum two-year appointment would be highly desirable. To provide some flexibility with regard to appointments of external representatives, contracts may be made for a one-year period subject to renewal. This would allow for a change in external representation should the need arise due to a change in deputy heads, due to an unforeseen change in audit committee requirements arising out of major departmental or governmental reorganizations, or due to requirements on the external representative's time which had not been foreseen at the time of appointment. However, a consideration in the appointment of an external representative would be an expressed willingness to serve for at least a two-year period.

Ideal audit committee

There is no ideal audit committee which will suit the requirements of every department or agency. The following models are therefore presented to aid departments in establishing the composition of a committee best suited to their particular circumstances.

Three models are provided which would likely be appropriate to all large or medium size departments or agencies, depending on their suitability. Although they are based on the chairperson and five members, the actual size of the committee may vary depending on the needs of individual departments and agencies and the attributes of the individual audit committee members.

In smaller departments and agencies, the cost effectiveness of the committee should be considered. It is unlikely, when audit activity is restricted to the Auditor General's annual attest audit and a periodic internal audit performed on a contract basis every 3 to 5 years, that a private sector representative and possibly even a representative from another department would be desirable. The effort required of such members to acquire knowledge of departmental operations and administrative practices might be disproportional to their contribution. Audit committees consisting of the management committee or some of its members would likely be adequate in such situations.

TYPE A AUDIT COMMITTEE

Suitability

This type of committee would likely be suitable for departments or agencies with no board, commission or advisory committee, etc., and with no restrictions on its memberships for security or other reasons.

Composition

<u>MEMBER</u>	<u>CANDIDATE</u>	<u>CONTRIBUTIONS</u>
1. Chairperson	Deputy head	<ul style="list-style-type: none">● Clear definition of the quality and quantity of advice needed.● Good understanding of the department and of the government.
2. and 3. Departmental representatives (program)	ADM (or equivalent) of a program or group of programs	<ul style="list-style-type: none">● Expertise in the department's operations.● Understanding of the department and government.● Objectivity towards department's administrative policies and procedures.
4. Outside representative -governmental	Senior executive of another department or agency who has responsibility for the administrative policies and procedures within his or her department.	<ul style="list-style-type: none">● Expertise in administrative policies and procedures within the government.● Experience in dealing with problems within his or her department.● Impartial viewpoint with regards to the department's operations and administration

<u>MEMBER</u>	<u>CANDIDATE</u>	<u>CONTRIBUTIONS</u>
5. External representative (1 member)	Senior executive of a private sector corporation with responsibility for operations in an organization similar to those of the department or agency.	<ul style="list-style-type: none">● Extensive management experience in an organization similar to those of the department.● A clearly impartial viewpoint with regards to operations and administrative policies and procedures of the department and the government.
6. External representative (2 members)	Senior executive of a private sector corporation with responsibility for administrative policies and procedures of his or her corporation.	<ul style="list-style-type: none">● Extensive management experience with regards to the administration of a large corporation.● A clearly impartial viewpoint with regards to operations and administrative policies and procedures of the department and the government.

Total membership: 6

(1 member as described in either 4. or 5.)

TYPE B AUDIT COMMITTEE

Suitability

This type of committee would be suitable for departments or agencies with a board, commission or advisory committee, etc., regardless of whether or not there are restrictions on membership for security or other reasons.

Composition

<u>MEMBER</u>	<u>CANDIDATE</u>	<u>CONTRIBUTIONS</u>
1. Chairperson		
2. and 3. Departmental representatives (program) (2 members)	The details for these first four members are identical to those for the Type A Audit Committee.	
4. Outside representative -governmental (1 member)		
5. and 6. External representatives (2 members)	Member of the board from outside the federal government with broad managerial experience.	<ul style="list-style-type: none">● Familiarity with departmental programs.● Understanding of the government.● Interest in the soundness of the administrative processes supporting decisions of the board, etc.● Experience in dealing with problems based on his or her management experience.● Impartial viewpoint on administrative policies and procedures of the department and the government.

Total membership: 6

TYPE C AUDIT COMMITTEE

Suitability

This type of committee would be suitable where there are restrictions on membership for security or other reasons and there is no board, commission or advisory committee, etc., from which to draw members.

Composition

<u>MEMBER</u>	<u>CANDIDATE</u>	<u>CONTRIBUTIONS</u>
1. Chairperson		
2. and 3. Departmental representatives (program) (2 members)	The details for these first four members are identical to those for the Type A Audit Committee.	
4. Outside representative -governmental (1 member)		
5. and 6. Additional outside representatives -governmental (2 members)	Deputy head of other department or agency	<ul style="list-style-type: none">● Overall knowledge of administrative policies and procedures of the government.● In-depth knowledge of government environment.● Experience managing his or her department (including dealing with audit committee).● Impartial viewpoint with regards to department's operations and administration.

Total membership: 6

CHAPTER THREE

DEVELOPMENT OF INTERNAL AUDIT PLANS

1. OVERVIEW

Planning, whether strategic or operational, whether long term or short term, is as relevant for internal audit as it is for any other activity. Also, as with all activities that have department-wide, functional implications, even though their resources may be confined to a discreet responsibility centre there is a requirement to do function as well as responsibility centre planning. The flow of planning for internal audit is depicted in Figure 1.

Function oriented planning, dealt with in this chapter, is department-wide in scope and is strategic and long-term operational in nature. Responsibility centre planning concentrates more on long-term infrastructural and annual plans and resources which will be dealt with in Chapter Four. Assignment planning will be introduced in Chapter Four and discussed in more detail in Chapter 1, Book 1 of Volume II, which deals with the audit assignment process.

To the degree that the Standards provide guidance as to how internal auditing should be planned for, the relevant standards should be incorporated in the planning process employed. The Standards that are considered the most applicable at this stage are Standards No. 2, 3, 12 and 13.

Since the internal audit group is typically a responsibility centre (RC) like any other responsibility centre, its planning process should conform to PEMS (Policy & Expenditure Management System), to the degree implemented in the host department or agency, and to internal departmental or agency planning guidelines.

Internal Audit Planning

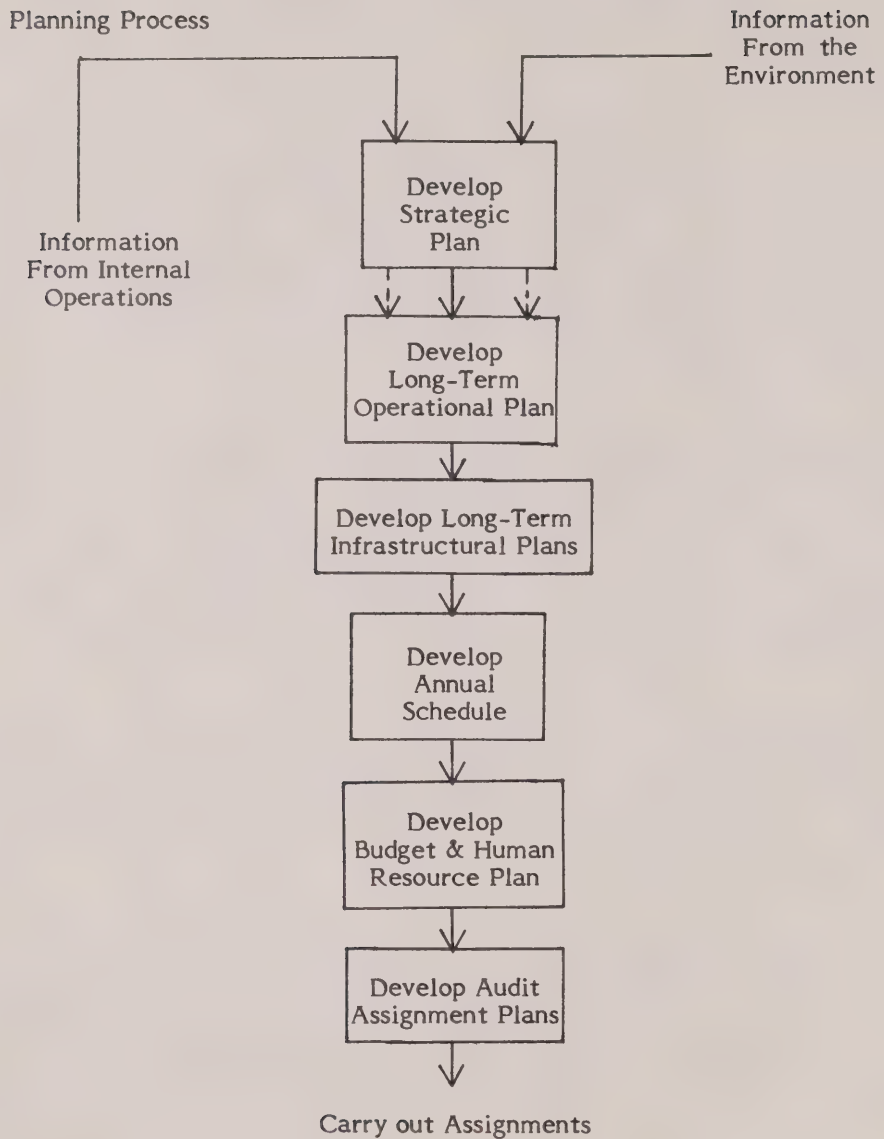


Figure 1

In what follows, an hierarchical framework based on two principles will be employed to describe the planning process:

- **The first principle recognizes that, in any endeavor, one must decide what is to be done and why before deciding how to do it.**
- **The second principle is that the what of a subordinate level of the planning process (e.g. Long-Term Planning Objectives) incorporates the how, to the degree defined, of the next higher level (e.g. Strategic Plan). This logic parallels that applicable to the respective managers of successive levels of an organizational hierarchy.**

Taking into account that the internal audit function is an instrument of the deputy head, it follows that the first event of the internal audit planning process should be the enumeration and ranking of the concerns that senior management wants dealt with.

A parallel activity to be undertaken is the enumeration and/or updating and refinement of the audit universe. The audit universe should include all potentially auditable units without regard for manageability, reportability or priority.

The raw data, obtained in the two parallel processes outlined above, may then be used to group elements of the audit universe into manageable audit units. As well, it may be necessary to develop a strategy for reporting on management concerns for those cases where the reports on manageable audit units will not adequately inform management on those concerns.

The important concept here is that there is not necessarily a one-to-one relationship between reporting requirements and manageable audit units (audit assignments).

Some issues have more impact (i.e. significance to management) when combined, others are more conveniently reported on as a derivative result of an audit of some other issue, while still others are not realizable within the timeframe of one audit assignment or even a series of assignments within an annual schedule and must,

therefore, be reported in two or more successive steps, including interim and aggregate, final versions. For example, in some cases a management concern will be better reported on by selectively summarizing or aggregating the results of several audit assignments into reporting units.

Finally manageable audit units are ranked as to importance, based on potential risk criteria, sized for macro resource requirements and consolidated into long-term plans, an annual schedule and associated resource plans.

2. DEVELOPMENT OF THE STRATEGIC PLAN

Introduction

Strategic plans provide the framework which allows an organization to adapt to changing circumstances. As a process, formulating strategy involves the following activities:

- 1) generating an adequate understanding of the organization as it currently exists;
- 2) scanning the organization's environment to identify issues and trends which could have an impact on operations (i.e. problems, opportunities, constraints);
- 3) developing a statement of where management wants the organization to be at some future point in time through the identification of objectives and goals;
- 4) analyzing the differences between where the organization should be in the future and where it is now; and
- 5) developing strategic plans which provide an approach to reaching objectives from the current position.

The intent of this chapter is to concentrate on the practical aspect of internal audit planning. Therefore, an expanded view will not be provided for each of the

activities noted above. This section will review only those aspects of strategic planning which give rise to problems, opportunities or constraints which have particular meaning for internal auditors. In this regard, two items have been isolated for review. First, the importance of identifying management concerns is reviewed. Second, reporting on management concerns is dealt with.

Importance of Identifying Management Concerns

The starting point for strategic planning is identification of strategic problems, opportunities and constraints, or generally, management's strategic concerns. There are three major ways in which management's concerns may impinge on the internal audit function:

- (a) The first is where a management concern translates into an audit issue to be reported on directly through audit reports from one or more audit assignments;
- (b) The second is where management's concern is such that it affects the emphasis placed on specific aspects of audit coverage or scope in some or all audit assignments (e.g. productivity improvement, communications, service orientation); and
- (c) The third is where management's concern affects the infrastructure of the internal audit function.

Type (a) concerns will be our main target in this chapter. Type (b) concerns will be absorbed in the assignment planning process. Type (c) concerns are part of the internal audit responsibility centre planning process and will be dealt with in Chapter Four.

Although type (b) concerns are being relegated to the assignment planning process, it is recognized that there are two ways in which such a concern can be dealt with. One is to reflect it in some or all audit assignments, as implied in the definition provided; the other is to convert it to an audit issue to be dealt with in a combination of one or more audit assignments. In the latter case it becomes a type (a) concern.

Which treatment a management concern gets depends on the relative urgency of the concern and on management's, and/or the audit group's preference as to methodology for dealing with it.

Senior managers need data or information to identify the need for decisions, and further data or information on which to base those decisions. In those cases where senior managers have insufficient information, they depend upon various sources, one of which is the internal audit function. Concerns then, are often identified in terms of the managers' decision-making process requirements, rather than in terms convenient for structuring manageable audit units (i.e. audit assignments). Consequently, management concerns must be translated into reporting requirements. Reporting requirements must then be translated into audit issues in order to be distributed to audit assignments. Also, since managers have many potential sources of information, and internal audit is not necessarily the most obvious one, it is only by a combination of reactive and proactive effort on the part of internal audit that all such information needs may be identified.

Concerns, as expressed by managers, generally translate into one of two classes of audit issue (sometimes both): those that are substantive in nature (i.e. goals, results or content oriented) and those representing systemic (i.e. structure or process oriented) concerns. In simple terms, substantive issues generally have to do with what is being done and systemic issues with how it is being done. As an example, the achievement of a specific level of service to the public is a substantive concern while the efficiency of the production system or process that led to its achievement is a systemic issue.

Figure 2 illustrates two levels of either systemic or substantive issue. The columns represent programs, where substantive concerns predominate, while the rows represent functional activities, where systemic concerns are the focus of attention.

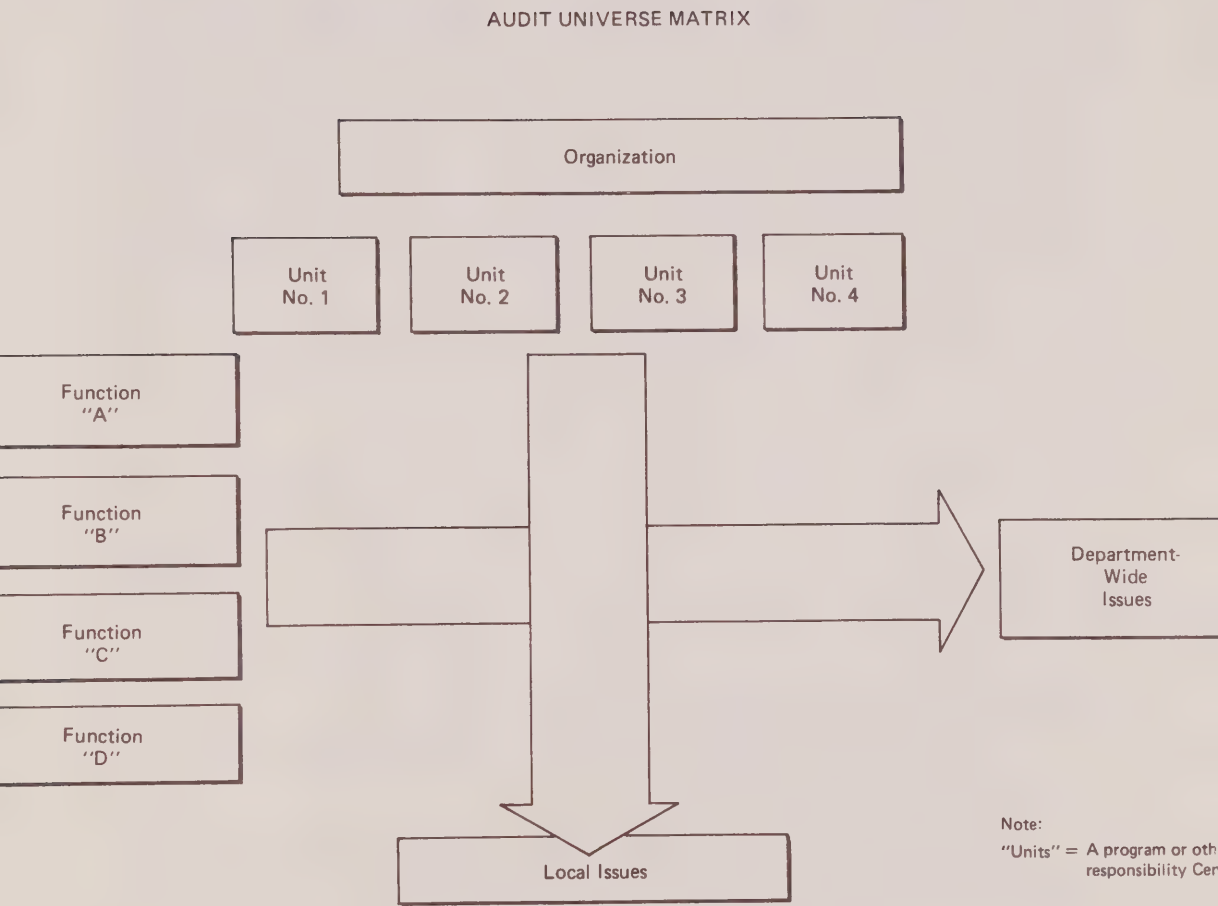


Figure 2

Audit issues then, as a representation of management's concerns, are introduced at this point for two main reasons. Although it is recognized that the majority of really urgent concerns will not surface with sufficient lead time to be included formally in strategic or long-term plans, there are some that will and they should be captured and absorbed in operational plans with as much lead time as possible. Secondly, there are many management concerns which are more or less ongoing. For example, it is hard to envisage long-term internal audit plans not reflecting a continuing, and frequent concern for financial and personnel resources, since they pervade the whole organization and represent the major resource concerns of management. Similarly on-going concern, on the part of senior management, is likely to be shown for key program areas, regardless of their perceived state of health or performance at any particular point in time.

The following are examples of sources of management's concerns.

- | | |
|--|--|
| 1. Individual Managers (Interviews) | 6. External Audit reports |
| 2. Management Information System reports | 7. Central Agency review reports |
| 3. Strategic Overviews, MYOPs, Estimates, especially Part III's, and other available plans | 8. Program Evaluation reports |
| 4. Management Services'/consultants' reports | 9. Audit Committee |
| 5. Internal Audit reports | 10. Departmental Management Committee reports or minutes |
| | 11. Parliamentary Committee proceedings, and parliamentary debate in general |

The identification of managerial concerns prior to development of long-term and/or annual plans has several advantages:

For management it:

1. Maximizes congruence between departmental/agency objectives and

2. Taps a valuable additional source of information for decision-making;
3. Improves the probability of timely information; and
4. Improves the probability that the department/agency will have a cost effective internal audit function.

For the Internal Audit Group it:

1. Aligns internal audit services with the needs of its clients thus improving its relevance and credibility;
2. Provides the maximum lead time for arranging audit assignments, in terms of content and timing, for optimal reporting impact; and
3. Allows the internal audit group to deploy its resources in the most cost effective manner.

From the foregoing the following premises for good planning may be derived:

- **Internal audit should maintain sufficient on-going communication with senior management to identify urgent management concerns and include them in audit plans with as much lead time as possible.**
- **On-going management concerns should be included in internal audit plans, regardless of the perceived state of health or performance of the object of those concerns at any particular point in time.**

Reporting on Management Concerns

As described previously, concerns, as expressed by management, are not always conveniently packaged for reporting and/or auditing in terms of audit assignments.

The concerns expressed may be too narrow in scope to be addressed from the framework of a normal audit assignment. In this case the audit group has two choices. It can combine them with other audit issues for purposes of efficient auditing, or if they are sufficiently material and/or urgent on their own, they may be converted to an audit issue or issues which are dealt with by scheduling a Special Audit. On the other hand, the resultant audit issue may be too big for one audit assignment. In this case the issue may be replicated in several audit assignments with appropriate roll-up of assignment report findings for presentation to management. It may also be distributed over several time periods (years), in which case serious consideration should be given to interim reporting as well as a roll-up. In any case, an audit which deals with a management concern or concerns will be referred to as a Reporting Audit Unit, and will represent the results of audit effort expended in one or more audit assignments.

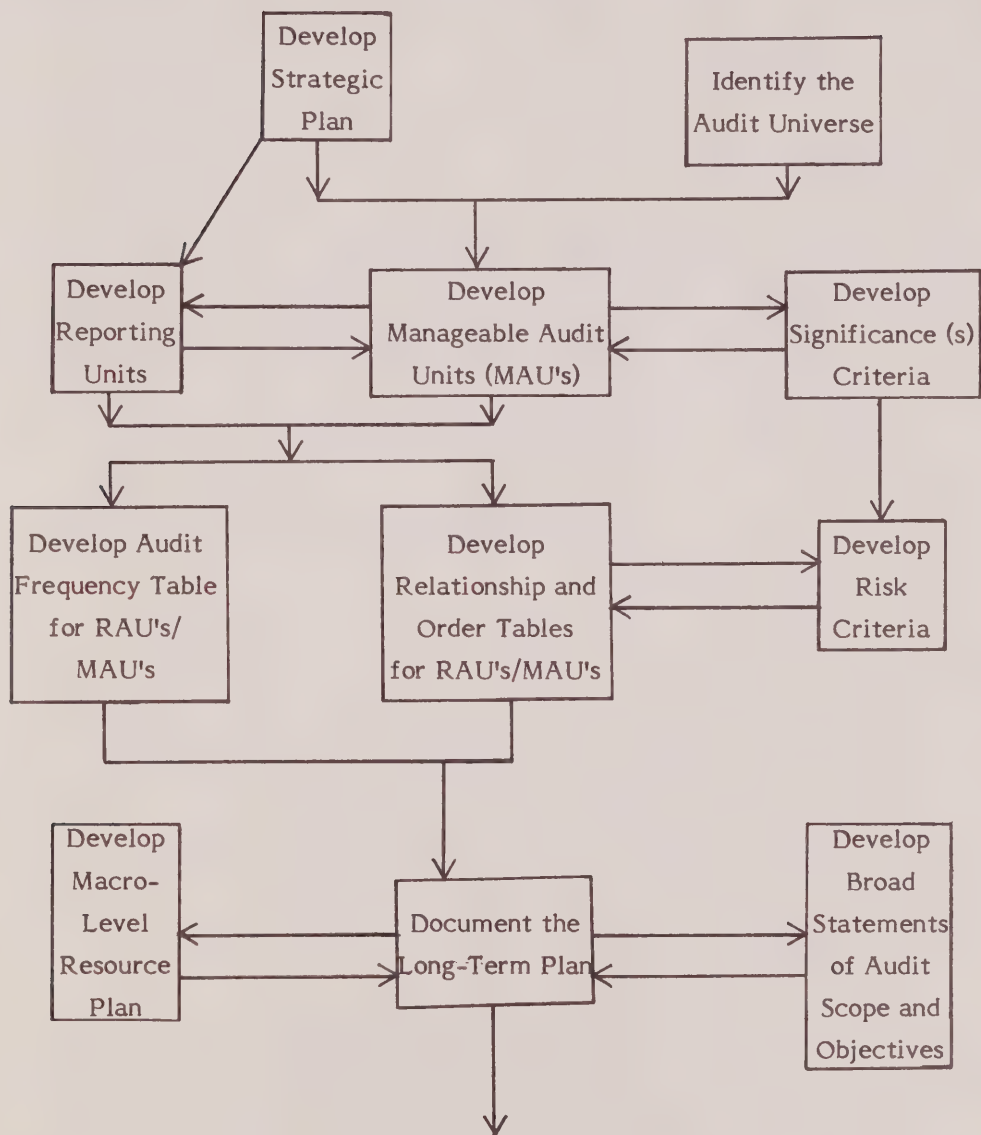
Therefore, **provision in the internal audit planning process for reports other than, or in addition to, the traditional audit assignment reports is desirable**, and in fact is being encouraged in order to improve the relevance of the internal audit function, as viewed by senior management. This suggested approach is an extrapolation from Standard 21 which reads: "A report shall be submitted to the deputy head at least annually on audit coverage, major findings, significant unresolved recommendations and any other matters requiring the deputy head's attention." (Underlining added for emphasis.)

3. DEVELOPMENT OF A LONG-TERM OPERATIONS PLAN

Introduction

As displayed in Figure 3, the long-term planning process consists of identification of the audit universe; combining the output of that activity with the output of the strategic planning process, and, based on significance criteria, reporting strategy and audit assignment strategy, developing a combination of manageable audit units (MAU's) and reporting audit units (RAU's) which meet the requirements of both senior management and the internal audit group.

Internal Audit
Long-Term Operational Planning Process



Legend

MAU = Manageable Audit Unit

RAU = Reporting Audit Unit

Figure 3

These manageable audit units are then arranged in a frequency table, based on their significance to management, ranked according to their perceived risk, and finally documented in an inclusive, long-term plan. This process is cycled between the internal audit group and senior management or the audit committee until there is agreement on significance/frequency for audit, and relative risk/order, then approved for implementation.

Identifying the Audit Universe

In principle, all organizational units which together comprise the total responsibility, for which the deputy head is accountable to his/her minister, are subject to audit. If they were all audited, they would represent total coverage of the audit universe, e.g. if all responsibility centres (RCs') were audited they would represent total coverage. Alternatively, all planning elements of the Operational Plan Framework (OPF) could be subjected to audit, thus providing equivalent coverage. Which is chosen as the basis for definition of the internal audit universe is not crucial as, ultimately, the two frameworks parallel each other and, in the ideal case, coincide.

Coverage of the audit universe need not include all RCs' or planning elements explicitly. An individual RC may simply not be sufficiently significant to management to warrant individual attention, (criteria for "significance" will be dealt with later). Alternatively, a large RC may not be convenient to audit within the framework of an audit assignment (i.e. it may not be manageable). The task at hand becomes one of identifying elements of the audit universe in a manner which will both allow their aggregation or disaggregation into auditable units which are both significant and manageable, and to demonstrate coverage of the complete audit universe, at some level of aggregation.

Regardless of how the audit universe elements are to be covered by audits in any one planning cycle, the enumeration of the elements of the audit universe should be on a sufficiently elemental plane to allow for raising or lowering of the level at which they are audited from planning cycle to planning cycle without redefinition of the universe. It is suggested that audit universe elements be enumerated to at least one level below the lowest level manageable audit unit, to provide this flexibility and to facilitate identification of the total possible scope of an

audit assignment. This imposes a requirement that the audit universe be identified in terms of its elements simultaneously with the development of manageable audit units. The identification of the audit universe should not be a mechanical listing exercise.

This approach will have several benefits. It will facilitate reconciliation of the contribution of coverage by internal audit and other audit and quasi-audit or review groups to overall control framework review, thus facilitating joint planning of audit coverage; it will facilitate recognition of relative risk potential to management; and, it will facilitate demonstration to management/the audit committee that not only were their expressed concerns dealt with, but that the risk of not dealing with undetected potential concerns was minimized as well.

In summary, there are two criteria to be met in identifying audit universe elements:

- 1) they must be physically recognizable, and
- 2) when aggregated, they must represent total coverage of the audit universe.

Developing Manageable Audit Units

Manageable Audit Units are groupings of audit universe elements which meet the test of significance (i.e. if subjected to audit, the resulting report will satisfy reporting requirements, at some level) and are of a size and scope such that they are logistically manageable within the framework of an audit assignment.

The phrase "at some level", above, refers to the fact that a manageable audit unit may be treated as an audit assignment for logistics purposes, although it is not considered sufficiently important to be reported on separately to senior management. In this case the audit assignment report is used as a means of communicating findings and recommendations to local and intermediate levels of management, and its contents are aggregated or synthesized with other such material for reporting to senior management.

Ideally, a list of manageable audit units would consist of those physically identifiable units (Responsibility Centres, Programs, Activities, Functions, Systems, Projects) which are considered to have high risk potential for senior management if

they do not perform as intended and are judged by the head of internal audit to fit conveniently into an audit assignment. In other words, they would be both significant and manageable. Also those physically identifiable units would be mutually exclusive.

As pointed out in the previous section, there will be cases where one or both conditions are not met and some form of aggregation of audit universe elements will be necessary. The means of aggregation may be either direct or indirect.

In the "direct" case, the coverage in any one long-term plan may be represented at the level of RC which, based on reporting requirements, is of direct significance to senior management. The higher the level of aggregation the lower the audit resource allocation per RC. It is important to note that the relative significance to management of any one RC may change from one planning cycle to the next, thus changing the level at which it is audited.

In the "indirect" case, where a sampling approach is used to satisfy reporting requirements, the assumptions made are twofold: first, it is assumed that the significance of any one RC in the sample (e.g. one of a set of district offices in a region) is not sufficiently great to warrant assignment of audit resources to it on its own; second, that activities/processes for the set are sufficiently homogeneous that a sample drawn from the population will be representative of all RCs in that category; and, that the results from an audit of a sample of such RCs will be representative of the whole population. This requires the creation of a Reporting Audit Unit so that the aggregate audit results may be properly combined for reporting to senior management (i.e. staff time must be allocated to gather the results of several audits and to prepare a report to senior management).

Some ways in which audit universe elements may be combined into manageable audit units (audit assignments) or reporting audit units are described below and represented in Figure 4:

A) Responsibility Centre Audit

A Responsibility Centre (RC) audit consists of an audit of all the important operations/activities undertaken by that RC (program or administrative), the management of that RC, and the impact of functional direction (program or support) on the activities of that RC.

Columns 1 and 2 of Figure 4 show responsibility centres which are significant. They are therefore both reporting and manageable audit units. In such a situation the major auditee is senior management. Derivative auditees would be immediate and intermediate management, and functional groups which impinge on the responsibility centre. Column 1, Figure 4 also represents a responsibility centre audit which may not be, by itself, sufficiently significant to report to senior management. In this case, it would probably be rolled up with other similar manageable audit units for reporting to senior management (as a reporting audit unit report) but would be reported on, as is, to local management (as a manageable audit unit report).

B) Organizational Audit

Organizational audits are RC audits where more than one, or parts of more than one RC are involved (e.g., a Division, Branch, a Region, an airport, a ship). In these cases, significance would normally be assigned to the highest level RC which would therefore become the reporting unit as far as senior management is concerned. The key distinction between an RC audit and an organizational audit is that an organizational audit will typically include, for example, a number of regional offices within a branch or a number of field/local offices within a region.

Illustration of
Manageable Audit Units in Terms
of Types of Audits
Auditable Audits

		1	2	3	4	5	6
Responsibility Centres (RC's)							
Department/Agency							
1.	Branch (Program A)			<div></div>	<div>S A M P L E</div>	<div>S A M P L E</div>	<div>S A M P L E</div>
1.1	Division (Activity A)						
1.1.1	Directorate						
1.1.2	Directorate						
1.1.3	Directorate						
1.2	Division (Activity B)						
1.2.1	Directorate	<div></div>					
1.2.2	Directorate						
1.2.3	Directorate						
1.2.4	Directorate						
2.	Branch (Program B)		<div></div>				
2.1	Division (Activity C)						
2.2	Division (Activity D)						
3.	Branch (Administration)				<div></div>		<div></div>
3.1	Division (Finance)						
3.1.1	Directorate (e.g. Accounting)						
3.2	Division (Personnel)					<div></div>	
3.2.1	Directorate (e.g. Staffing)						
3.3	Division (Systems Development)						<div></div>

Figure 4

Each responsibility centre within the audit unit is assumed to be manageable, however, it may not be considered significant, and therefore reportable, at least as far as senior management is concerned. It may however be possible to group certain RCs into a sampling population and use a sample of that population to form a manageable audit unit. It is, therefore, possible that adequate coverage of the audit unit may be provided without visiting all the subordinate RCs during a specific planning cycle. Those RCs that are visited should receive some form of feedback (a report, or at least a management letter). An organizational audit which includes sampling is illustrated in column 3 of Figure 4.

C) Functional Audits

A functional RC (e.g., Finance, Personnel etc., or a program) is one which provides functional direction, advice, and sometimes services to other RCs within the organization. Generally, direction is provided through the issuance of formal policies and directives and other similar mechanisms. The functional audit must include review of the effectiveness, efficiency and economy of the direction or service being provided by the functional group and the extent of adherence to its policies. To avoid duplication of effort, the audit may be accomplished by reviewing pertinent information from recently completed RC or organizational audits. Column 5 of Figure 4 illustrates a functional audit of the Personnel Function, while column 4 illustrates a combined organizational-functional audit, since it includes an audit of branch management as well as of the financial function.

For a functional audit, a major client, in addition to the deputy head, is the head of the function subject to audit. The head of the function is also the main auditee. Derivative auditees are other, lower level groups within that function and the selected RC managers that were part of the sample.

D) Program Audits

A program audit is a responsibility centre audit of the RC charged with the overall responsibility for the program (e.g. a branch) and, where applicable, all or a sample of the program related operations of the program's responsibility centres (e.g. regions, field offices).

A program audit may be identical to a responsibility centre or organizational audit. In other cases it may be similar to a functional audit. Column 2 in Figure 4 illustrates a program audit. It should be noted that RC 2, which has overall responsibility for the program, is audited as if a responsibility centre were being audited. Although it would be possible to audit only specific program activities in this RC, the administrative and management practices within this RC would be expected to affect overall program performance. It is therefore considered desirable to audit this type of RC in its entirety as part of a program audit.

It is suggested that for program audits the internal audit group plan a joint internal audit-management project for the purpose of developing a mutually agreed to, predetermined control model, including acceptance criteria well in advance of any contemplated audit. Plans should reflect this two-phase approach where it is adopted.

E) Systems Audit

Although the term "Systems Audit", if one were to take the most generic definition of the word "system", would include all types of audit unit described above, the term as used here is meant to include only systems in the narrower sense as used by EDP or systems and procedures staff.

A systems audit is an audit of a system used by any functional or line unit, or any combination of the two. This type of audit is similar in nature to the functional audit in that it is carried out by performing:

- i) A review of the organizational unit which is responsible for the overall design and/or maintenance of the system (the administering unit, typically the EDP group);
- ii) A review of the organizational units which host (own) the system (input and output); and
- iii) A review of a sample of the users of the system.

The audit may differ from the functional audit in two ways:

- i) The system may be administered or used by either operational or functional organizational units; and
- ii) Direction normally flows in two ways:
 - a) The administering unit provides direction on how to use the system, and
 - b) The host (owner) unit provides direction on the inputs the system should accept and the output that the system should provide.

Column 6, Figure 4 provides an illustration of this type of auditable unit, where Finance is the host unit.

F) Pre-implementation Audit

The audit of proposed legislation, policies, systems, contracts, etc., prior to their implementation.

These audits are concerned generally with the degree to which the mechanism under design will exhibit post-implementation manageability and auditability, and specifically with the adequacy of controls being built into the proposed mechanism. They are performed at various points during the specification/development/design/implementation/

turnover process, when the cost-effectiveness of such a review is highest. A second type of review that may be included in the audit scope at this time is an audit of the development process itself.

G) Special Audits

This type of audit is usually for the purpose of reporting on an issue that does not fit readily into a manageable audit unit or an array of MAUs. It would include unscheduled audits requested by senior management, unexpected audits caused by some fraud or defalcation incident, etc., as well as scheduled, issue oriented audits. Although these individual events are often unforeseen, a blanket, contingency provision can, and should, be made in both the Long-Term Plan and Annual Schedule to accommodate them.

Requests for special audits which are expected to absorb significant resources, and which would cause planned audits to be rescheduled, should be considered and approved by the deputy head or audit committee.

In summary, the identification of management concerns which resulted in reporting requirements, was one of the major activities in the internal audit function's strategic planning process. In the Long-Term Planning process these requirements are translated into audit issues which, along with other significance criteria, are used to influence the process of converting audit universe elements to manageable audit units and reporting audit units.

By organizing audit universe elements into manageable audit units, which are some combination of RC Audits, Organizational Audits, Functional Audits, Program Audits, and Systems Audits, most managerial issues can be reported on. These may be either directly reflected in audit assignment reports or require a synthesis or roll-up of findings into summary or special reports (i.e. reporting audit units) for reporting to senior management. The remaining issues can then be covered by Special Audits.

In those departments or agencies where the audit universe elements are too numerous, or not of sufficient significance to be treated as individual manageable audit units, some means is needed to determine how they should be aggregated such that they provide audit results which are meaningful to management while satisfying the test of manageability. In what follows an illustrative example will be developed that uses a significance index for deciding on the appropriate level of aggregation.

Criteria for Aggregating Audit Universe Elements into Reporting Audit Units/ Manageable Audit Units

From the foregoing it may be seen that there are three "tests" to be employed in reconciling (aggregating or disaggregating) audit universe elements and reporting requirements. In this context "aggregating" represents a "bottom-up" approach (i.e. from audit universe elements to either manageable audit units or reporting audit units). While disaggregating represents a top-down approach. The use, advantages and disadvantages of each approach will be dealt with later in this section.

The three tests, referred to above, are significance, manageability and coverage. Significance criteria will be used to determine reporting audit units (reporting assignments), manageability criteria to determine manageable audit units (audit assignments) and the criteria for coverage is simply that the whole audit universe must be represented by audit universe elements, at some level (i.e. the list of audit universe elements must be inclusive).

Ignoring, for the moment, the approach to be used for aggregating/disaggregating audit universe elements, what will be demonstrated first are the various ways (methods of combination) in which audit universe elements may be reconciled with manageable audit units and reporting audit units.

In Table 1 combinations are shown, which represent five of the methods of combining audit universe elements into either manageable audit units, reporting audit units or both.

Table 1
Aggregation of Audit Universe Elements

<u>Method</u>	<u>Audit Universe Elements (AUEs)</u>	<u>Manageable Audit Units (MAUs)</u>	<u>Reporting Audit Units (RAUs)</u>
1	0001	001	01
2	0002 0003 0004 0005	002	02
3	0006 0007 0008	003	03 04
4	0009	004 005	05
5	0010 0011 0012 0013 0014 0015 0016 0017 0018 0019 0020	006 006 006	06

Method 1 represents the ideal case, where there is a one-to-one relationship between the audit universe element, the manageable audit unit and the reporting audit unit. However, a real world department/agency is seldom amenable to reconciliation in such a straightforward fashion.

Other combinations that are likely to occur are as follows:

- Method 2, where the significance test indicates that audit universe elements 0002 to 0005 are not significant to senior management in themselves and the manageability test indicates that elements 0002 to 0005 are more efficiently audited as one audit assignment. In this case the audit assignment report will also be the basis of the report to senior management. The report to senior management (i.e. the reporting audit unit) may be in the form of a summary.
- Method 3 represents a more complicated case in that two reports to senior management are required (reports 03 and 04) even though only one audit assignment report (no. 004) is contemplated. This can occur when senior management wishes a special report on the whole, or some aspect, of an audit universe element (e.g. suspected fraud or abuse) or when senior management wishes a special report on an issue which spans several elements and/or units. The audit group is then required to synthesize another report which covers audit findings and conclusions on the remaining portions of the manageable audit unit.
- Method 4 demonstrates the case where the audit universe element is too extensive to be one manageable audit unit, but where senior management wishes only one report. In this case, results of audit assignments nos. 004 and 005 are combined and summarized into report no. 05 for senior management.

- Method 5 represents the sampling approach to coverage. It represents an audit where a sample of audit universe elements is audited as one manageable audit unit in order to provide one report to senior management.

What remains now is the demonstration of how significance criteria may be used to arrive at reporting audit units. To do this we need some measure of "significance" which incorporates a representative sample of significance criteria as shown in Table 2¹ (i.e. a significance index).

The starting point for assigning significance indices to audit universe elements is management concerns, which have been translated into reporting requirements and packaged as reporting audit units, which clearly should meet the threshold test.

However, the process cannot end there for two reasons. Meeting the threshold test at a specific level (e.g. Branch) does not preclude subdivision into reporting audit units at the next lower level which also meet the threshold test. Also, expressed management concerns will not necessarily represent a range of audit universe elements which assure total coverage.

1 A more complex, and more rigorous method of determining significance (risk) indices is described in Appendix C.

Table 2
Table of Significance Criteria

CRITERIA	DETERMINANTS
(a) size	usually determined by <ul style="list-style-type: none">• revenue generated• expenditures made• assets controlled• person years
(b) risk	risk is a function of <ul style="list-style-type: none">• the extent and reliability of the control system• the vulnerability to loss• the vulnerability to criticism through poor products and services• political sensitivity
(c) major changes	<ul style="list-style-type: none">• major changes in systems or organization• the implementation of new systems• the establishment of new organizations• changes in key personnel
(d) previous internal audits	<ul style="list-style-type: none">• dates• findings and recommendations• the extent of follow-up and corrective action by management <p>(The discovery of major deficiencies in one unit may necessitate audits of similar units.)</p>
(e) work of other auditors or consultants	The reports and audit plans of <ul style="list-style-type: none">• the Auditor General• the Comptroller General• Treasury Board• other evaluation groups• consultants
(f) concerns and needs of senior management (reporting requirements)	<ul style="list-style-type: none">• Have priorities been identified by senior management?• Has senior management made a specific request for an audit to be done?
(g) special considerations	provision for other criteria which may have an impact on the ranking process.

The only way to assure both reporting significance and coverage is to undertake a systematic top-down examination of organizational elements for significance greater than a predetermined threshold. Although this exercise may also be undertaken starting from the lowest level organizational elements (i.e. bottom-up), in most cases it would be more efficient using the top-down approach. In small organizations it is likely that reporting audit units and manageable audit units will be identical and these will most likely coincide with audit universe elements. In this instance there will be little or no difference in efficiency, between the two approaches. In the case of large organizations, not only will the bottom-up approach not be efficient, it may not even be feasible. With either approach, the results achieved should be identical.

A significance index within a predetermined range (say 1 to 1000), based on a subjective evaluation of one or more of the significance criteria shown in Table 2, could be negotiated with management and assigned to organizational units within the department. Then, based on a threshold, agreed to with management, the audit head would decide on reporting audit units.

The ideal case, where all manageable audit units turn out to be reporting audit units (according to the threshold test) is illustrated in Table 3, based on the hypothetical organization depicted in Figure 5. The more likely case, where manageable audit units and reporting audit units do not coincide is illustrated in Table 4, also based on Figure 5.

In this illustration, RCs 1112 through 1114 are not sufficiently significant, at that level of aggregation, to warrant reporting to the deputy head/Audit Committee individually, however, they meet the requirements as manageable audit units. They will be audited individually and reported on to local management and the head of Finance (see Figure 5) individually, then rolled up under reporting unit no. 1 for presentation to senior management (deputy head/audit committee, ADM Admin.).

The methods by which audit universe elements may be combined into manageable audit units and reporting audit units has already been illustrated in Table 1.

Organizational Chart
Department Z

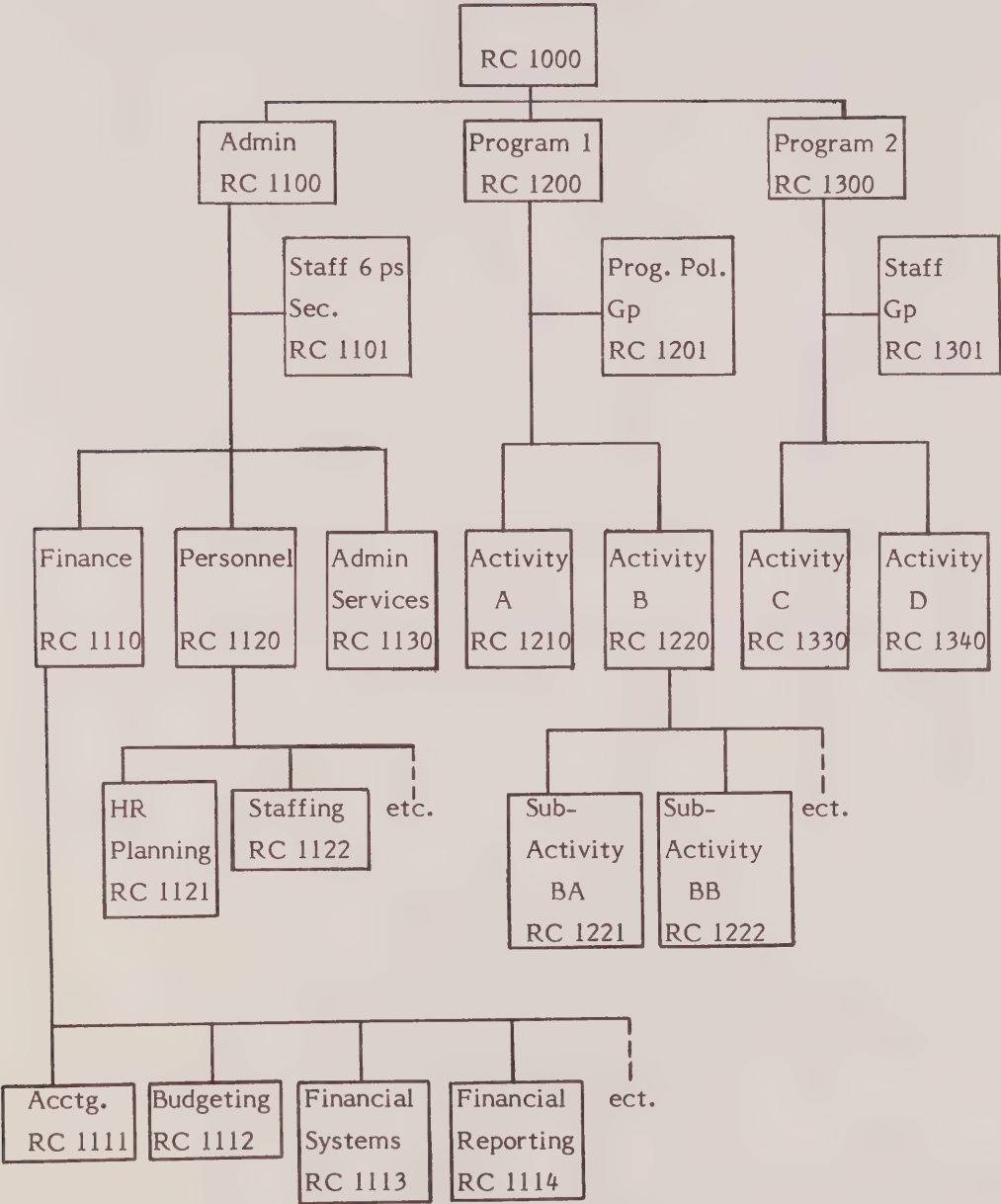


Figure 5

Table 3
Development of Manageable Audit Units/Reporting Audit Units
(MAU = RAU)

	<u>AUE</u> ¹	<u>Significance Index</u> ²	<u>MAU/RAU</u>
RC	1000	1000	
RC	1100	500	
RC	1101	100	
RC	1110	300	1
RC	1111	250	2
RC	1112	150	
RC	1113	150	
RC	1114	150	
RC	1120	300	3
RC	1121	150	
RC	1122	100	
RC	1123	100	
RC	1124	100	
RC	1200	900	
RC	1201	200	4
RC	1210	250	5
RC	1211	300	6
RC	1212	275	7
RC	1220	500	8
RC	1221	175	
RC	1222	100	
RC	1223	150	
RC	1224	100	

Legend

AUE = Audit Universe Element
MAU = Manageable Audit Unit
RAU = Reporting Audit Unit

Note:

- 1 See Figure 5
- 2 Range = 1 to 100 (for each significance criteria used)
Threshold = 200

Table 4
Development of Manageable Audit Units
and Reporting Audit Units
(MAU ≠ RAU)

	<u>AUE</u>	<u>Significance Index</u>	<u>MAU</u>	<u>RAU</u>
RC	1000	1000		
RC	1100	500		
RC	1101	100		
RC	1110	300	110	1
RC	1111	250	111	2
RC	1112	150	112	
RC	1113	150	113	
RC	1114	150	114	
RC	1120	300	120	3
RC	1121	150		
RC	1122	100		
RC	1123	100		
RC	1124	100		
RC	1200	900		
RC	1201	200	201	4
RC	1210	250	210	5
RC	1211	300	211	6
RC	1212	275	212	7
RC	1220	500	220	8
RC	1221	175		
RC	1222	100		
RC	1223	150		
RC	1224	100		

Given that a top-down approach is used, what has been demonstrated in Tables 3 and 4 is an enumeration process appropriate to any size organization. In this case a threshold of 200 is being used, i.e. any unit scoring greater than 200 is considered a reporting unit.

In the top-down case the planner would work down the hierarchy (progressively disaggregate) until the threshold is crossed, i.e. the unit scores below 200 (let this be level n). If the units at this level are all manageable audit units then all units at that level become audit universe elements and the next higher level (level $n+1$) is the reporting unit level. The exception to this rule is where the unit at level n is not yet a manageable audit unit (i.e. too large), in which case the planner continues to work down level by level until manageable audit units are identified. These are then rolled up for reporting purposes, as described before and illustrated in Table 4. Again, the level at which audit universe elements are identified should be at least one level below the level of the manageable audit unit in order to provide planning flexibility.

It may be readily seen that if the top-down method of determining manageable audit units/reporting units is chosen then the enumeration of the audit universe necessarily follows, rather than precedes, the manageable audit unit/reporting audit unit development process. Where level n is found not to coincide with the lowest level RC's in the organization the top-down approach will be more efficient than the bottom-up approach.

Ranking the Audit Units

The next step in the long-term planning process is to rank manageable audit units into a priority list, (according to their relative risk potential or significance) so that they may be sized, in terms of macro-level resource requirements and scheduled over an appropriate timeframe into a formal Long-Term Plan.

The proposed process for identifying issues, defining manageable audit units and ranking them will undoubtedly be iterative in nature as significance may have to be determined before a decision can be made as to an audit universe element's, or an audit issue's importance.

The process of identifying manageable audit units and reporting audit units, by itself, is of little value unless a method for scheduling them is established. Ranking of audit units serves two purposes. First, it provides a basis for deciding how frequently audit units should be audited. Second, it provides a method for determining in what order those units should be audited (refer to Table 6). In what follows, frequency and order are both determined on the basis of the audit unit's significance to management. However, for those interested in a method with greater rigour, a more advanced technique is presented in Appendix C.

In the development of the long term plan, the frequency of audit of manageable audit units is a key consideration. In many cases, frequency of audits has been expressed in terms of fixed time intervals (cycles) for a department's organizational components, such as regions, branches or responsibility centers (e.g. Finance -every 3 years; planning - every 4 years; program A -every 5 years). Experience has shown that frequency expressed solely in these terms has tended to result in some audit units being given unwarranted equal priority in successive planning cycles. Hence, a sub-optimization of scarce audit resources can occur.

Assigning a reporting or manageable audit unit a frequency without regard for its current state tends to eliminate a key decision point in the plan development process, that of setting or changing the frequency on the basis of significance to management.

The extent and frequency of recurring internal audits depend upon varying circumstances such as: conditions found during previous audits or the lack of previous audit; performance reflected in management reports; overall importance to organization; and adequacy of the internal control system. Therefore, no general rule can be established as to the number of times each activity should be audited in a particular timeframe. Nevertheless, whatever frequency of audit is selected for a manageable audit unit, it should be commensurate with the level of risk resulting from the failure to audit it (i.e. its significance to management). Therefore an appropriate frequency assignment technique should be an integral part of a thorough and well-documented planning process.

Use of Significance Criteria in the Determination of Audit Frequency

The Standards for Internal Audit introduce the concept of frequency of Audit (Standard No. 3), and imply that one can have a variable frequency, (3 to 5 years). However, no guidance is provided to demonstrate that this frequency might be expected to vary from audit unit to audit unit and over time, nor what criteria is to be used to decide on the frequency to be assigned.

In this section it is suggested that the criteria to be used to determine significance are the same as those used for ranking audit units (see Table 2). The process for assigning frequency with which audit units should be audited should be distinct from the process for ranking them.

Even if the same absolute rank (significance index) is used for both purposes, a scale of thresholds would have to be developed which would provide the basis for converting a rank to a frequency.

Level of significance may be determined by judgementally assigning a number of one to "n", ("n" being an arbitrary upper limit to the range over which significance/ rank will be assigned). This number will, presumably, be based on some implicit notion of significance based on the criteria supplied in Table 2 and arrived at jointly between the audit group and management, or determined independently by the audit group and approved by management. A joint determination is preferable if management concerns are to be adequately (efficiently and effectively) reflected. (N.B. This is the same method used in an earlier section in the discussion of the development of manageable audit units and reporting audit units). An example of such a frequency determination process is demonstrated in Table 5.

A more rigorous rank/significance determination process is possible. This would entail taking each element in Table 2, assigning range and weighting factor scales to each (in order to provide for relative importance of each criteria) and totalling the product of range factor and weighting factor indices for any one reporting or manageable audit unit to arrive at an overall ranking.

In doing this, two caveats must be considered. One is that the various elements in Table 2 would have to be defined such that they are mutually exclusive, if they are to be summed without double counting. And two, the process should allow for a normalization routine if different numbers of elements are used for arriving at the rank for each audit unit.

For a discussion of a ranking technique that demonstrates this please refer to Appendix C.

One final point; as departmental programs, activities, systems, etc., wax and wane in importance over time, with new ones being added and existing ones dropping off or becoming less significant, it is important that the frequency table be updated accordingly.

Ranking as to Order of Audit

In any organization, the function of planning requires that certain activities be executed in preference to others, particularly in the face of scarce resources. The audit environment is no exception. To effectively utilize limited resources, a ranking of the various alternative entities that form the audit universe must occur. As in the case of frequency assignment, discussed above, this ranking is not expected to be stable over time as various audit units will either increase or decrease in priority based on more current information as to their state of effectiveness, economy and efficiency, and their relative importance.

Table 5
Assignment of Frequency of Audit to MAUs

Frequency Assignment Table (5A)

<u>RAU/MAU</u>	<u>Rank/Significance</u> (Scale of 1 to 20)	<u>Frequency</u> (See scale ¹)
1	5	5
2	4	5
3	11	3
4/(41, 42, 43) ²	14	3
5	1	5
6	3	5
7	7	4
8	8	4
9	20	2
10	2	5
11	6	4
12	9	4

Frequency Table (5B)

<u>Frequency</u>	<u>MAU</u>
Two Year Cycle	9
Three Year Cycle	3, 4
Four Year Cycle	7, 8, 11, 12
Five Year Cycle	1, 2, 5, 6, 10

Legend

MAU = Manageable Audit Unit
RAU = Reporting Audit Unit

Note

1 Frequency Scale

<u>Rank/Significance Range</u>	<u>Frequency (Years)</u>
1-5	5
6-10	4
11-15	3
16-20	2

2 RAU No. 4 consists of a roll-up of MAU's 41, 42 and 43.

3 RAUs may, in some cases, be single entry (one-shot) units based on independent (as opposed to ongoing) management concerns.

As discussed in the section above, "Use of Significance Criteria in the Determination of Audit Frequency", the criteria in Table 2 may be used as a basis for determining the relative rank/order of the manageable audit units, (see Table 3). A more convenient version of a rank/order table, for scheduling purposes, is shown in Table 6. Here the original assigned rank (from Table 5) is inverted and collapsed such that the MAUs appear in the order in which they will appear in the long-term planning schedule.

It is preferable to decide on frequency of audit explicitly on the basis of significance, whether by use of the criteria discussed in this chapter, Appendix C, or some other equivalent, but equally explicit method. The more explicit the method is, as to the underlying assumptions made, the better. Furthermore, the decision as to frequency and order should be reviewed periodically on the basis of changes in the control framework, and therefore significance/risk potential in the intervening period.

The advantages gained would be:

- 1) decisions will be based on a consistent, rational and explicit basis;
- 2) the underlying assumptions will be visible and easily reviewed to see if they still hold;
- 3) the decisions made will be less mechanistic, more closely aligned with the decision criteria used by management, i.e. risk avoidance; and
- 4) this approach should result in more efficient use of audit resources.

Develop Long-Term Plan

Table 7 displays a completed long-term planning schedule based on frequency requirements, as reflected in Table 5 and order requirements per Table 6. It is assumed that sufficient resources exist in the audit group to accommodate the activities assigned to each year, otherwise resources and/or audit priorities must be renegotiated.

Table 6
Order of Audit Table

<u>Original Rank</u>		<u>Collapsed and Inverted Rank/Order</u>	
<u>Rank/Order</u> (Highest = 20)	<u>RAU/MAU</u>	<u>Rank/Order</u> (Highest = 1)	<u>RAU/MAU</u>
1	5	1	9
2	10	2	4/(41, 42, 43)
3	6	3	3
4	2	4	12
5	1	5	8
6	11	6	7
7	7	7	11
8	8	8	1
9	12	9	2
10	-	10	6
11	3	11	10
12	-	12	5
13	-		
14	4/(41, 42, 43)		
15	-		
16	-		
17	-		
18	-		
19	-		
20	9		

Legend

RAU = Reporting Audit Unit

MAU = Manageable Audit Unit

Table 7
Long-Term Planning Schedule

	Year				
<u>RAU/MAU</u>	1	2	3	4	5
9	---		---		---
4/(41, 42, 43)	---			---	
3		---			
12			---		
8		---			
7			---		
11				---	
1				---	
9					---
2				---	
3					---
4/(41, 42, 43)					---
6					---
10					---
5					---
Development	---	---	---	---	---
Planning	---	---	---	---	---
Training	---	---	---	---	---
Other	---	---	---	---	---

Legend

--- = Timing undetermined.
RAU = Reporting Audit Unit
MAU = Manageable Audit Unit

The long-term plan should include a display explaining how both managerial concerns and the audit universe are being covered and the resources are assigned; providing a general statement of scope and objective for each of the audit units and, where practical, some indication of anticipated benefits or results; demonstrating coverage of relevant central agency policies; providing for special audits; and, showing the extent and nature of non-audit activities.

The general statements of scope and objectives need not be unique for each manageable audit unit. For example, standard wording could be provided for all the major types of audit (e.g. Responsibility Centre Audits, Organizational Audits, Systems Audits and Pre-implementation Audits) on a word processor and then minor differences could be readily developed for specific instances. Of course, special audits would need unique statements of scope and objectives.

Conclusion

The attention any manageable audit unit gets, from the manager and auditor alike, should be based on the potential risk of not giving it that attention. For example, in making an independent decision that some, or all, of the financial functions will be audited once every three years the head of internal audit is implicitly assuming that the financial function is a high risk area, - higher than all those being audited less frequently. More than that, the head of internal audit is implicitly assuming that that function will continue to be a high risk area year after year no matter what efforts are made to improve it over those years. Neither of these assumptions are necessarily valid in all cases, for all time.

Some departments and agencies, particularly small ones (in terms of budget \$'s and PY's), will not be high risk areas in terms of resource costs. However, they may be highly visible and crucial to the government in either political or social terms, or both (e.g. Federal Mediation and Conciliation Service, in the Department of Labour; Legislative Programming, Department of Justice).

Table 8 provides a display of responsibilities associated with the internal audit planning process. Activities 8 and 9 will be dealt with in the next Chapter.

Table 8
Responsibilities Associated with
Internal Audit Planning

Activity		Responsibility		
		I A	Sr. Mgt.	Audit Comm./DM
1.	Ident. mgt. Concerns	Suggest	Provide	Advise/Approve
2.	Ident. Audit Issues	Develop	Influence	
3.	Dev. RU's	Develop	Contribute to criteria and assgt. of significance factor	Advise/Approve
4.	Dev. Strategic object plans	Develop	Influence	Advise/Approve
5.	Dev. Audit Universe	Develop	Contribute to criteria and assgt. of potential risk factors	
6.	Develop MAU's	Develop	-	
7.	Develop L-T Plans	Develop	In House	Advise/Approve
8.	Develop Ann. Sched.	Develop	In House	Advise/Approve
9.	Develop Resource Plans	Develop		Advise/Approve

CHAPTER FOUR

MANAGEMENT OF THE INTERNAL AUDIT GROUP

1. OVERVIEW

Managing the internal audit group is not unlike managing any other organization. In its simplest form management deals with establishing goals then seeing that they are met through the effective and efficient utilization of human, physical and other resources. Managers must be able to establish goals, devise plans, develop organizational structures, policies, systems and procedures, acquire and allocate resources, direct the efforts of people, and control events so that goals will be met effectively, efficiently and economically, or simply effectively, if one takes the global meaning of the term effectiveness.

Managing is one of the most important areas of organizational activity, because all managers, at all levels and in all kinds of endeavors, have a basic task of designing and maintaining an environment in which people can grow and develop while accomplishing pre-determined organizational goals. Successful management thus requires a managerial temperament; the ability and inclination to inspire others to move toward desired organizational goals.

The process which managers follow to achieve these objectives can be broken down and categorized into three main functions which include: planning, implementation and controlling. In a recent Treasury Board publication¹, implementation is represented by organizing, leading and communicating (see Figure 4.1). Any complete discussion of the management process should include all these elements. Without meaning to understate the importance of other elements of the management process, it can be stated that the role of communication is particularly vital to the success of the internal audit function. Surveys indicate that modern internal auditing is highly charged with communications, in one form or another. It must be remembered, however, that these elements, although distinct in themselves and subject to scrutiny and analyses individually, do not exist apart from one another; they are interdependent.

¹ Principles for Management of the Public Service of Canada, Treasury Board of Canada; 1983.

THE MANAGEMENT PROCESS*
(For Audit Purposes; Main Activities Complete With Common Elements)

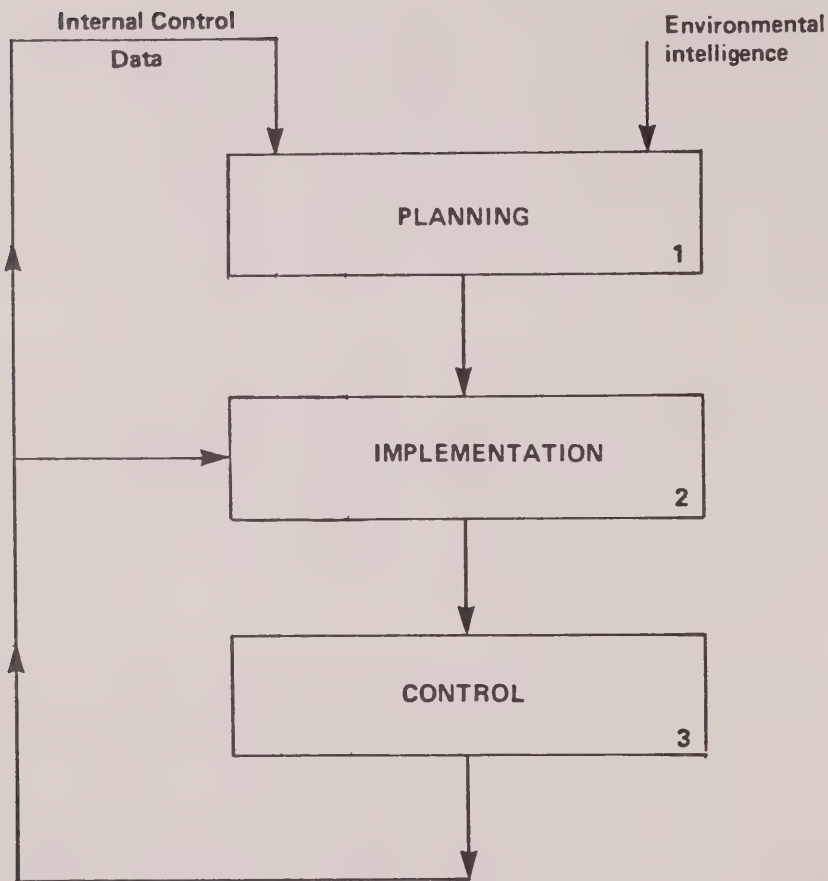


Figure 4.1

* Drawn from the Guide to an Audit of the General Management Process.

The management process is recursive, resulting in a loop effect as illustrated in Figure 4.2. Managers plan, organize their resources, lead people and then measure results. This in turn forces further decisions to be made in the process, depending on deviations between actual and intended results.

Planning

Planning is decision-making which involves selecting the courses of action that an organization will follow. At the highest level in the organization, it is the determination of strategic goals and the formulation of major strategies, i.e. strategic plans. At the lowest level it is the planning of the detailed, day-to-day tasks which must be implemented to achieve the goals of the entity.

Planning bridges the gap between where we are and where we want to be in the future. Although the future can seldom be predicted with accuracy, and unforeseen events may interfere with the best-prepared plans, planning does provide valuable lead time for those events that can be foreseen. To the extent to which there is planning and that planning is comprehensive and of high quality, the probability of success for the organization is enhanced.

The previous chapter dealt with planning at the function level (i.e. strategic and long-term operational planning).

In this chapter, responsibility centre planning will be emphasized. To the degree that function planning and responsibility centre planning overlap the processes described will be duplicated, however, the substance will not.

Implementation

Implementation consists of two major components: organizing and leading.

Organizing is that part of managing that involves the acquisition, deployment and maintenance, of resources with respect to activities and the development of policies, systems and procedures to ensure their proper utilization. As such, it includes establishing a formal structure of responsibilities, roles and authorities. It is through

this structure that the various work activities are further defined, classified, assigned and coordinated. A major focus of organizing encompasses the selection of the right people for the tasks involved. This means not only selecting people who have the education, training, experience and skills needed to do the job, but choosing individuals who are properly motivated. Resource acquisition also includes facilities (e.g. space, furniture and fixtures), materiel (e.g. clerical supplies, calculators, computers) and funds.

Leading involves the provision of guidance through good communication and leadership. It has to do with encouraging and motivating people to contribute effectively and efficiently toward the accomplishment of organizational goals. As such, managers must understand the various approaches to leadership and the extent to which they influence employee behaviour, the various motivational techniques and the importance of communication in linking the various management functions.

Controlling

Controlling is the process of making certain that planned, organized and directed action is carried out as intended in order to achieve some desired goal. Controlling and planning are linked since the results of planning are used both as guidelines for implementation and for determining the degree to which plans are being met (i.e. control).

RELATIONSHIPS AMONG MANAGEMENT FUNCTIONS

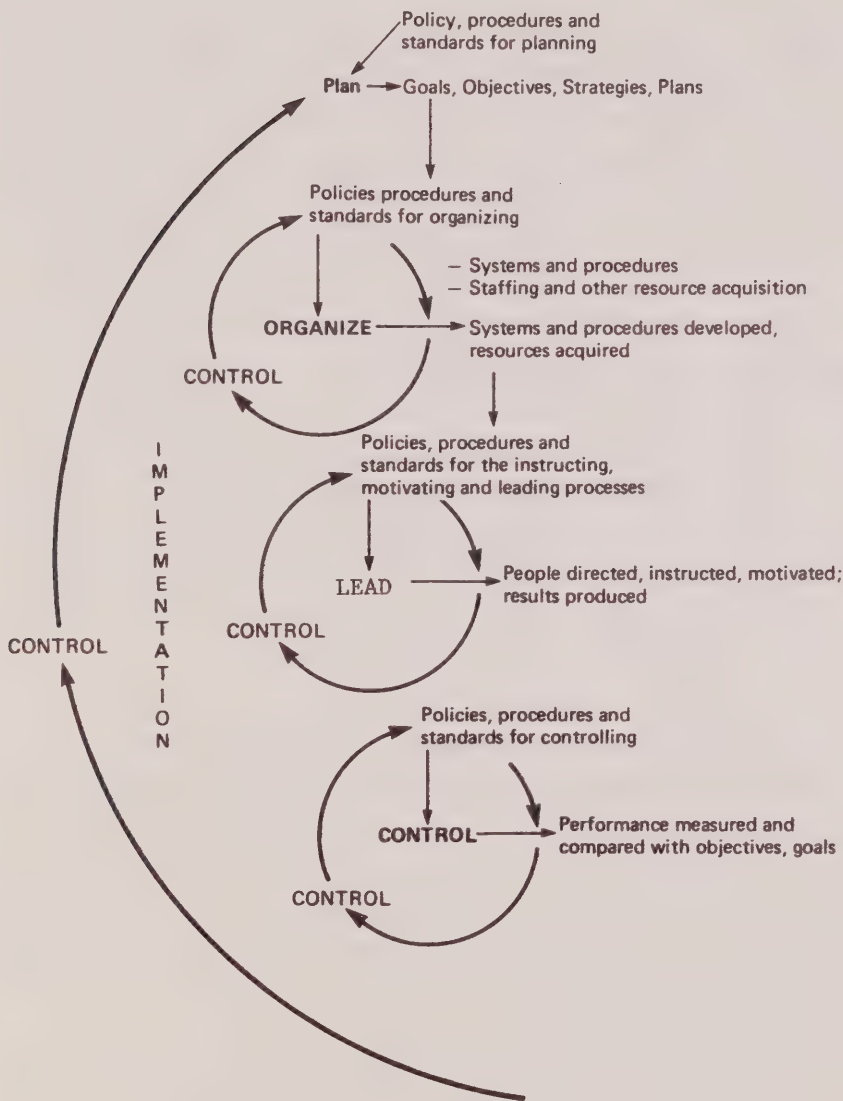


Figure 4.2

2. RESPONSIBILITY CENTRE PLANNING

To meet its mandate in an effective and efficient manner, the head of an internal audit group must carefully plan its activities. Planning in the context of internal audit can be divided into two broad categories: function planning (Chapter Three) and Responsibility Centre Planning (see Figure 4.3). The focus for function planning is the department as a whole. Accordingly, the primary concern is how the function interacts with its host organization at that level. The vehicles for dealing with this level of concern are strategic planning, including the establishment and development of the internal audit policy and identification of departmental concerns, and long-term planning which ensures adequate coverage of the audit universe. The concerns of responsibility centre planning are the long-term infrastructural plan (which includes provision for strategic infrastructural initiatives), the annual schedule and associated resource plans/budgets and assignment planning. The purpose of this section is to integrate strategic, long term and short term planning activities which form the basis of internal audit as a responsibility centre. It is these plans which form the basis for directing and controlling audit activities as well as measuring the performance of the audit group.

Responsibility centre planning, of course, includes the whole series of planning phases from intelligence gathering through to operational planning (see Figure 4.4), including resource planning/budgeting. However, because intelligence gathering, strategic planning and long-term operational planning are, in this case, joint activities having mostly to do with development and coverage of the audit universe they will not be treated in detail except as they impinge on the responsibility centre planning implementation and control process.

Levels of Planning
in a Department/Agency

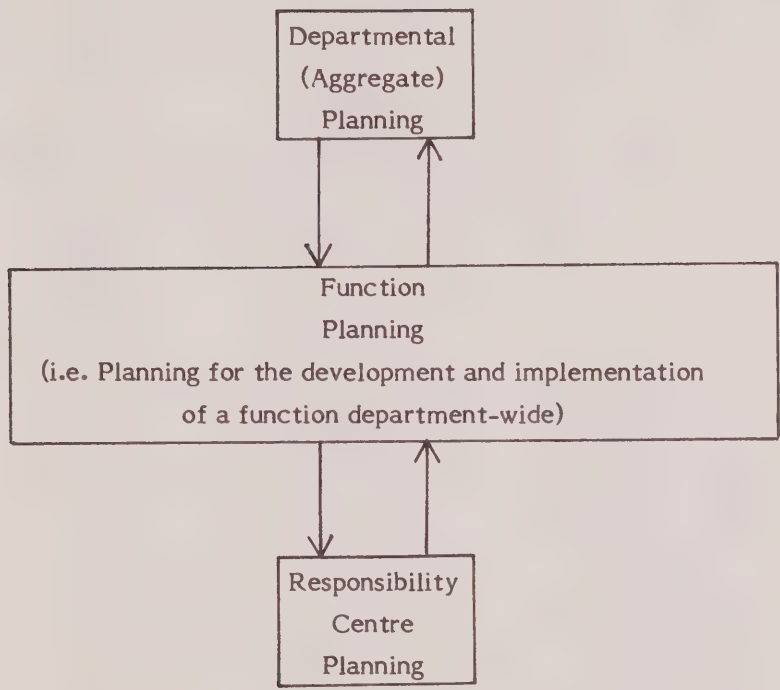


Figure 4.3

THE MANAGEMENT PROCESS:
GENERIC PLANNING PROCESS OVERVIEW
(Responsibility Centre Level)

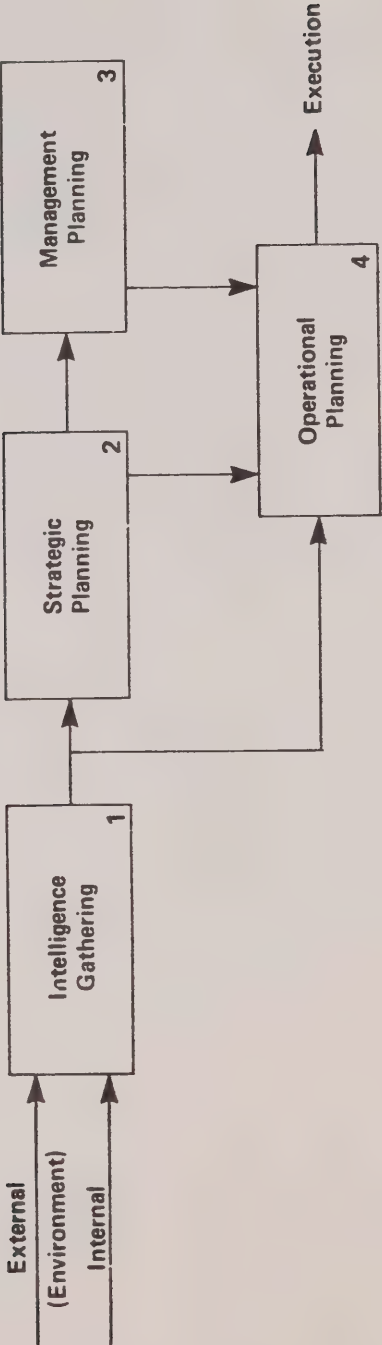


Figure 4.4

Specifically, internal audit function planning has addressed such concerns as: creation, development and revisions of the internal audit policy; strategies on definition and design of auditable units (e.g. optimum size and type of audit, definition of "major" and "significant", priority strategy) and the managerial concerns they are to address.

Long-Term Infrastructural Planning

Long-term infrastructural planning (shown as management planning in Fig. 4.4) has to do with providing plans for acquiring or developing the capability to carry out the operations planned for in the long term plan in an effective and efficient manner, i.e. planning for the internal audit infrastructure.

It includes such things as: organization structure, size and skill set of the staff (including management review groups where they are an integral part of the function); reporting relationships, audit committee relationships, external relations; responding to department-wide thrusts (e.g., realignment of program activities/organization); responding to department-wide policies (e.g. official language policy, special employment policies etc.); resourcing strategy (e.g., hire, second, rotate, promote, contract, use of core or in-house auditors vs specialists or contract personnel); staff training and development strategy (e.g., make/buy, in house/outside training, generalist/specialist, etc.). These strategic issues would normally have to be developed in conjunction with the deputy head and audit committee, and be approved by the deputy head. Policy, including such things as official languages, resourcing and staff development strategy, would involve the heads of the various functional groups.

In planning for systems and procedures, an area crucial to the success of any internal audit group is the development of general-use audit work instruments such as audit guides, programs and/or techniques.

The impetus for the development of an audit guide, or associated work instruments, normally arises from the identification of a need for a structured and consistent approach in an audit area for which no such framework exists. Alternatively, it may derive from the requirement to conduct a major revision to an existing guide to reflect current thinking and the present requirements of the particular audit environment.

In the case of functions which are common across the government, the identification of a need for guides will likely emanate from the IACIA, or its sub-committee responsible for the development of audit methodology, possibly in conjunction with the expressed concerns of heads of internal audit. Within individual departments and agencies, assessment of the need for audit guidance frequently will arise in the course of preparing a long term audit plan or even during post audit analysis of completed audit assignments.

Once a need has been identified it will be necessary for the IACIA or the head of internal audit of a department to clarify the exact requirements and decide whether to refer the need to the IACIA or create a departmental project. In the first case, general specifications should be written up which can be submitted to the IACIA in order to set the parameters for the establishment of a project.

Once the nature of the project is determined (i.e. departmental versus IACIA project), the need for resources can be identified and reflected in the plans.

The Long-Term Infrastructural Plan, and the Annual Schedule described below, are developed within the framework of the strategic and long term operational plans and, therefore must be consistent with them.

The Annual Schedule

Audit Standard 13 of the Standards for Internal Audit states: "An annual schedule of planned audit assignments shall be prepared and submitted to the deputy head for approval."

During this phase, specific assignments to be carried out during the year ahead are scheduled for audit. The schedule should provide some balance so that a variety of audit units are covered each year.

The schedule should also include a description, in considerably more detail than in the long-term plan, of each assignment in terms of:

- the purpose, scope and objectives of the audit assignment;

- required resources, including human and non-human;
- estimated timing, including starting and completion dates and total person days.

It should also provide for scheduling of non-audit related activities such as professional development, leave, developmental work and any other administrative or non-audit related activities.

The schedule should be developed such that audit effort is effectively coordinated. It should be reviewed with other audit/evaluation/review groups both within and external to the department. Audit assignments should be scheduled in such a way as to ensure that full use can be made of knowledge gained from completed work. This is particularly relevant for program type audits where much of the audit methodology, work instruments and techniques are relatively new and experimental. Consequently, there is much need for post-audit review and evaluation of audit assignments to determine the deficiencies in the audit process in order to improve subsequent audits.

Both the long term plan and the annual audit schedule should provide appropriate resource time for post audit reviews and evaluations as well as developmental work. Over the medium to long term the overall effectiveness and efficiency of the internal audit function should benefit proportionately.

Planning is a continuous process and the audit manager must be continuously vigilant for changes in the audit universe in his or her organization which may affect the nature, scope and frequency of planned audits. Such changes should be properly reflected in the audit plans.

Adjustments to the long term plan and annual schedule can be caused by a number of factors including:

- changes in the departmental structure caused by a major reorganization including decentralization/centralization actions;

- significant changes in senior management ranks, especially at the deputy head level. This may or may not result in changes in the audit universe elements but may affect their prioritization to reflect the concerns or desires of newly-installed senior management;
- changes in the audit resource base; or
- requests for special audits.

Aggregation for the Annual Schedule

The long-term operational plan described in Chapter Three was prepared with a primary emphasis on Reporting Audit Units (RAUs), in order to more clearly emphasize the needs of senior management. It is now necessary to aggregate the audit universe elements in a way that will facilitate the audit work to be done.

The long-term plan will have included components of manageable audit units (MAUs) as follows:

Long-Term Plan			
Year 1			
	MAU 1	MAU 2	MAU 3
RAU 1	X		
RAU 2	X		X
RAU 3	X	X	X

It will now be necessary, for annual scheduling purposes, to reaggregate the elements as follows:

Annual Schedule			
	RAU 1	RAU 2	RAU 3
MAU 1	X		X
MAU 2	X		X
MAU 3 (RAU 2)		X	X
RAU 1	X		
RAU 3			X

The manageable audit units are the audit assignments to be performed in the current year and the reporting audit units are to be translated into specific audit objectives of the assignments. Those reporting audit units which are not simply a summary of, or abstraction from, one MAU (e.g. RAU 1 and RAU 3) are listed as assignments along with the MAUs since additional resources are required to complete them.

Finally, the MAUs and RAUs which absorb significant resources would be reflected in an annual schedule, along with other audit related projects and activities, (see Figure 4.5).

Resource Planning

The budgeting process provides for person-year and financial resources, however, from the point of view of resource planning there are physical aspects of resource acquisition and use that need to be planned for, in addition to budget considerations. This entails human resource planning and facilities and material planning (see Figure 4.6).

Annual Schedule

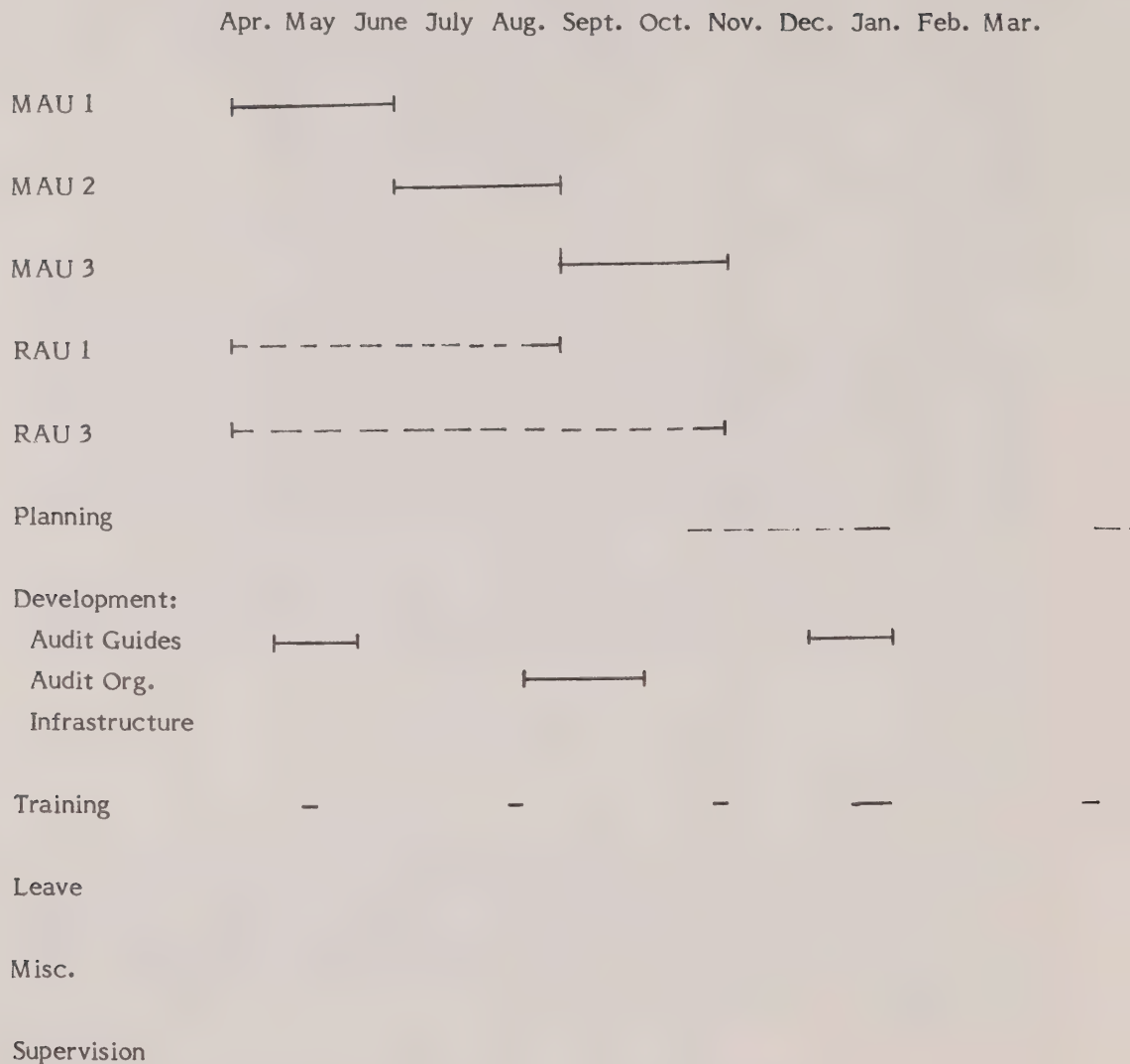


Figure 4.5

a) Budget Planning

The budget is usually the most, if not the only, visible result of the resource planning processes. It typically consists of salary and non-salary components covering all expected expenditures for the coming year (see Figure 4.6).

In cases where the staff complement and workload are stable the budgeting exercise is no more than an extrapolation of the previous years figures, adjusted for projected salary increases and inflation. It is only when instability is expected that additional planning is required. When required, both human resource planning and facilities/material planning should precede the budgeting process. Since the budgeting process is usually well delineated in departmental policies and procedures manuals, no more will be said about it here.

RESOURCE PLANNING

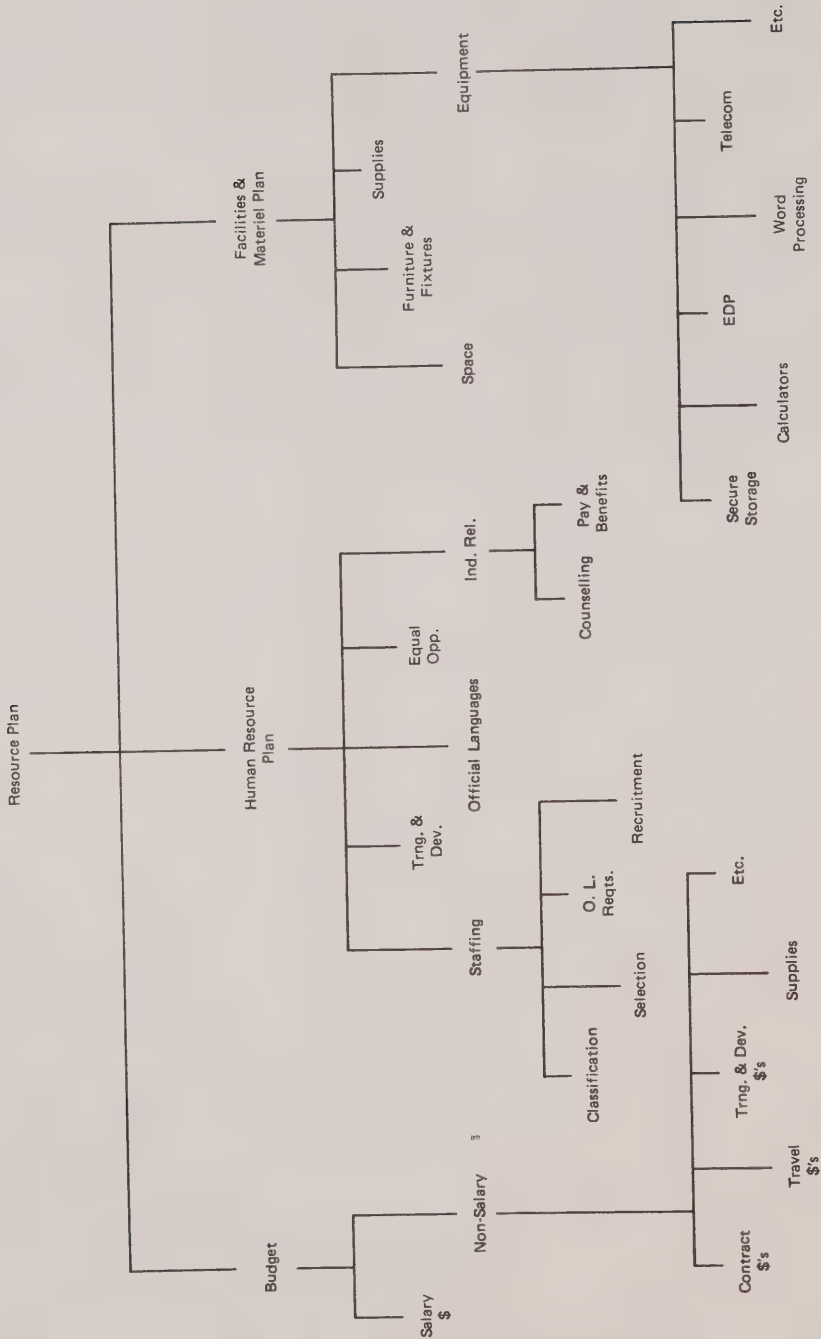


Figure 4.6

b) Human Resource Planning

Human resource planning is often a neglected area in responsibility centre planning. For this reason, it will be given separate treatment here, from the point of view of the unique concerns of the internal audit function.

The scope of modern internal auditing is such that a wide range of skills is required to carry out the range of internal audit assignments faced during the course of any one year. No one individual is likely to have all the required skills. Therefore, the degree to which an internal audit group will be able to assemble the range of skills required, and the methods chosen to accomplish this, will depend on a number of factors.

To start with, given the focus, or perspective, of modern internal auditing (i.e. the manager's view of departmental operations, in general, and of internal control, in particular), the skill set required of any one internal auditor is broader than it used to be.

When internal auditing was synonymous with financial auditing, the skill set required was accounting and auditing. In this case an individual with an accounting designation, (e.g. CA, CGA, RIA) was considered adequately equipped, in terms of knowledge base.

Now that internal auditing has changed, in both scope and perspective, the requirements for the auditor's knowledge base have changed accordingly. The minimum knowledge requirements for any auditor, particularly a senior auditor, now include auditing, management and, preferrably, one more functional-administrative skill such as accounting, personnel, etc. In those departments where the systems and procedures (processes) are heavily dominated by EDP facilities and techniques, EDP knowledge would be an asset as well.

While a junior auditor could function without management training in the short-term, given that even operations level controls are examined from the managerial perspective, there would have to be close supervision by a senior internal auditor with the full complement of skills, including management.

Considering that skill is a combination of knowledge and experience it is evident that the ideal auditor would be one who has both academic training in management and experience as a manager. This raises a dilemma, as the current classification structure is such that it is highly unlikely that the junior auditor will have had the opportunity to acquire actual, hands on, managerial experience. The auditor may, however, have acquired the next best form of experience by acting in a management consulting capacity prior to joining the internal audit group.

Where the internal audit group is too small, or where the requirement in terms of workload is insufficient to justify the full range of skills required, alternative arrangements need to be planned. These would include contracting, secondment and term employment.

In the first instance, planning for human resources entails comparing the requirement for human resources, in terms of amount, skill and timing, to the resource pool that exists. If this process results in a gap then an array of techniques are available for dealing with it, including:

1. Reorganization of the annual schedule, audit assignment composition (i.e. type, and therefore scope, of the audit assignment), or re-allocation of audit team members to audit assignments;
2. Training, for short-term gaps, and development for longer-term ones;
3. Recruitment/staffing (indeterminate, term) and/or divesting staff;
4. Rotating staff (within the department, with other departments or central agencies);
5. Seconding staff;
6. Executive interchange;
7. Participation in the Career Assignment Program (CAP);

8. Participation in the Career Orientation Program; and
9. Contracting.

All the foregoing techniques require a certain amount of lead time if they are to be effective, therefore, they should be explicitly planned for.

Additionally, other human resource oriented initiatives that need to be planned for and coordinated with related department-wide initiatives include: official languages (requirements, recruitment, training and development), equal opportunities (recruitment, training and development), security (clearance, change in requirements) and possibly, counselling.

c) Facilities and Materiel Planning

Just as with human resource planning, the degree of facilities and materiel planning required will depend on the stability of the internal audit function's environment.

Figure 4.6 provides a breakdown of the components of the facilities and materiel area of concern. Of particular concern recently are the areas of word processing, EDP and telecommunications. Word processing, because of its extensive use in documentation preparation, and more recently, because of its increasing use for information storage and retrieval purposes.

Electronic data processing (EDP), word processing and telecommunications are the building blocks of recent thrusts in office automation. If internal audit groups are to take advantage of potential efficiency and effectiveness benefits a considerable amount of advance planning will have to take place.

The timing of such planning is particularly crucial where the host department has already initiated activity in this area; it is much more difficult to retrofit internal auditing needs to an existing plan, or worse still, an existing facility.

Much of the current development activity in the office automation area is centred on improved capability and support for "knowledge workers". In the context of auditing several areas of application are worth considering:

1. Information storage and retrieval:

- 1.1 Key index for cross-referencing manageable audit units and managerial issues at the planning stage, in order to reconcile coverage of the audit universe with coverage of issues.
- 1.2 Related to 1.1; a cross-reference between audit assignment results by several indices (e.g. by reportable issue or subject, by organization, by function/activity, by date, by team leader/member, etc.).
- 1.3 Working paper storage, assembly and retrieval, cross-referenced by finding, by issue, by function/activity, by organization, etc.). This would be particularly useful where a department-wide issue or functional audit is being carried out, and therefore, several team members, possibly working in several parts of the country, are contributing to one common working paper file. The data could be input and cross-referenced from remote terminals, thus shortening the time interval for assembly of findings and report development, speeding up the validation/response/action plan development process, and the follow-up process. This approach is, of course just as applicable for any audit assignment where several auditors are contributing to a common file of working papers, and eventually to a single report.

2. Analytic techniques (decision aids)

- 2.1 Statistical sample design, selection and analysis.
- 2.2 Use of other statistical methods as decision aids (e.g. correlation/regression, factor analysis, bayesian decision analysis, queueing theory models, monte-carlo simulation, statistical cost-benefit analysis, etc.).
- 2.3 Use of deterministic decision/analysis models (e.g. deterministic net present value/internal rate of return analysis, variance analysis,

linear regression, decision trees, decision tables, EDP software simulation, etc.).

3. Administrative Aids

3.1 Filing correspondence by multiple index.

3.2 Automated library systems.

3.3 Time reporting and analysis systems.

3.4 Project control systems.

3.5 Economy/efficiency/effectiveness reporting systems.

3. ORGANIZING

Organizing activity develops the required infrastructure (e.g. organization structure, systems and procedures, methodology), acquires people, facilities and other resources, and arranges them in logical groupings to carry out plans and meet goals. The action taken to organize the internal audit activities at their highest level becomes one of the major strategies for achieving the goals and objectives of the internal auditing function. Most of the efforts in this area are, however, directed to implementation of management plans.

Organization of the Internal Audit Group

The Standards for Internal Audit require that all departments or agencies that are subject to Treasury Board policies have an internal audit capability. This does not necessarily mean that all departments and agencies will have an internal audit organization or an internal audit group. Some smaller departments or agencies may choose to contract for their internal audit services.

While the use of outside resources is often a viable alternative, there are a number of advantages to using in-house resources, where justified for cost or other compelling reasons: departmental orientation and empathy is enhanced, training

requirements may be reduced; knowledge and experience gained by the auditor is retained by the department; and departmental managers are often more comfortable with "in-house" internal audit staff than contract personnel.

A side benefit of having an internal audit group can accrue if the internal audit function is used as a training ground for staff and operational managers, through rotation and exchange with departmental operations. Operational managers tend to gain a better perspective of their department or agency, as well as additional insight into control practices and evaluation. Internal auditors may get to "walk a mile in the manager's shoes" in the rotation offsets.

Where it has been decided that an internal audit group shall be established there are a number of ways in which it can be structured. However, essentially two organizational structures appear to emerge as most suitable for internal audit purposes. They are the normal hierarchical structure and the matrix or pooling structure. They are illustrated in Figures 4.7 and 4.8. (Although the illustrations provided are more applicable to large departments they can be readily down-sized for smaller departments/agencies.)

In the normal structure, the reporting relationships are hierarchical and are most suited to those internal audit groups that decided to split the review activities by types of audits i.e. functional, program, etc., or along organization lines. The tendency here is towards specialization. The matrix or pooling structure is best suited to those audit functions which possess a broader, more heterogeneous, set of skills within the group. The current trend is towards integration. Hybrid configurations which exhibit elements of both approaches are possible as well.

In addition to the line-oriented activities of the audit group, some consideration should be given to allocating appropriate resources within the organizational structure to audit-related activities such as planning, developmental work, quality control and other essential administrative tasks essential to supporting the overall effectiveness of the function. These decisions should, of course, be justified on a cost-benefit basis.

Finally, internal audit managers may wish to allocate some of their approved person-years to secondments, rotations, trainees, etc.

Given the range in size and complexity of government programs and activities it is obvious that there is no one best organization structure. Each internal audit group should adapt its organization structure to accommodate its own unique and specific requirements.

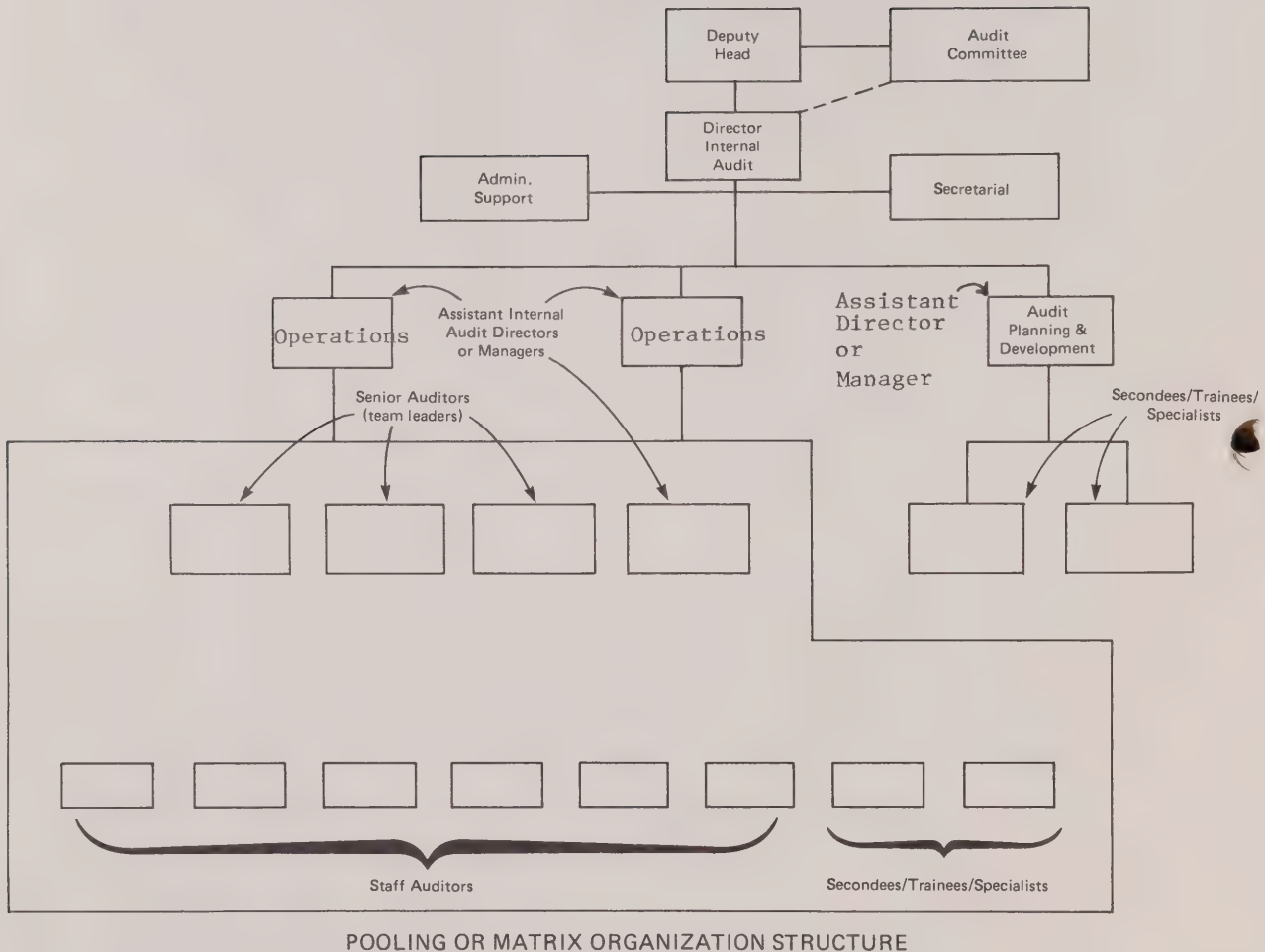
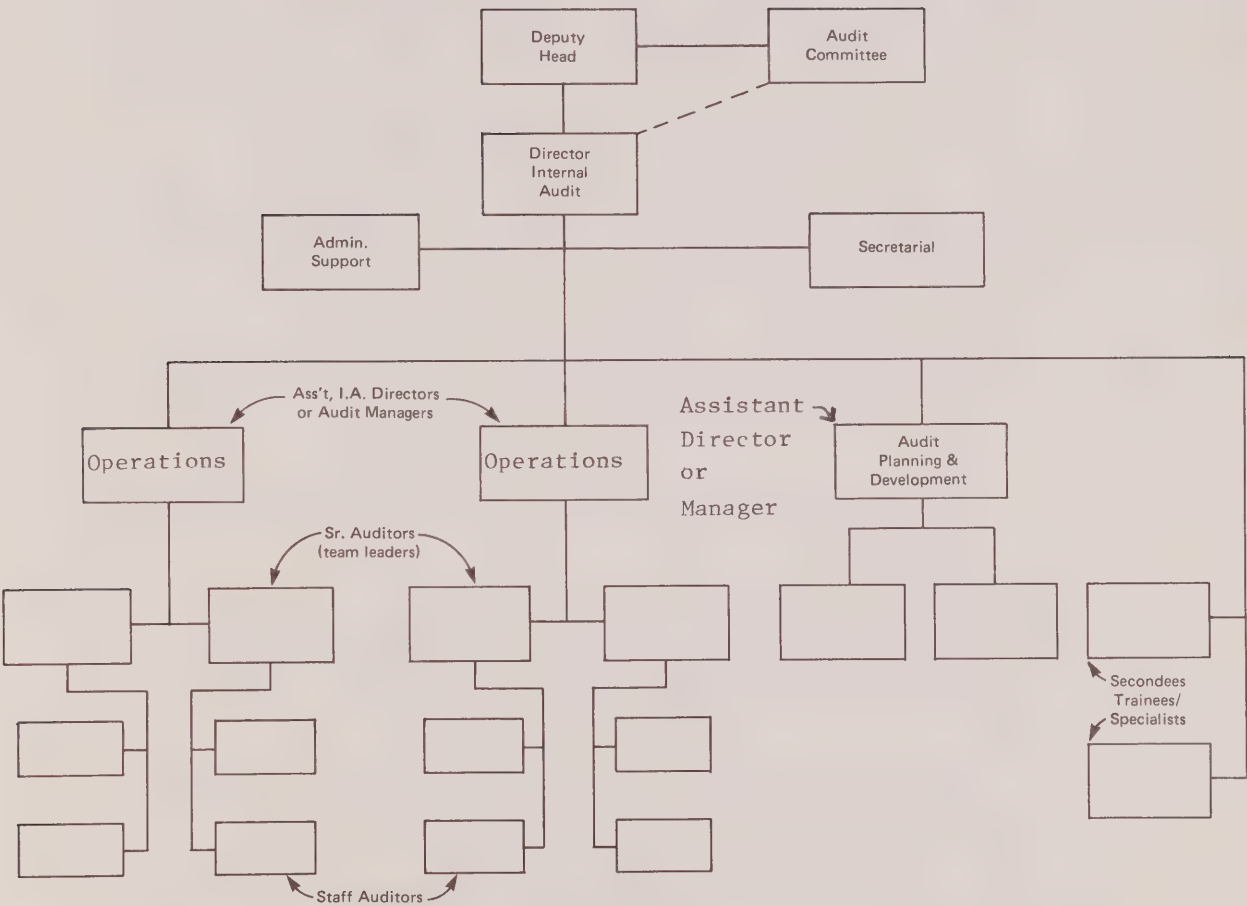


Figure 4.7



HIERARCHICAL ORGANIZATION STRUCTURE

Figure 4.8

However it is structured the internal audit function should generally be organized in a single group independent of the operations it must review. It should not be subdivided, with separate groups reporting to program or functional managers. There are several reasons for this. A single internal audit group reporting to the deputy head, or to a senior executive officer who reports directly to the deputy head:

- provides greater independence thus facilitating objectivity;
- provides a better perspective on department-wide issues from a senior management viewpoint;
- fosters a broader viewpoint on the interrelationship of organizations and functions within a department or agency;
- places the internal auditor in a better position to make systematic evaluations and appraisals of all departmental programs, activities and operations;
- facilitates a more efficient operation by minimizing duplication of effort and administrative resources; and
- facilitates the attraction, retention, development and management of staff.

Although the internal audit function is expected to provide useful feedback to all levels of management its primary orientation is to higher management. Therefore it must have staff with the appropriate collective skills and knowledge, both technical and managerial, to be able to successfully view the organization through the eyes of the management it serves. The reasons for this can be demonstrated in both efficiency and effectiveness terms.

To the degree that the department wants to get maximum output for every unit of resource expended, the internal audit function is no exception. The internal audit head is expected to deploy resources such that the most material (significant) issues

in terms of pay-back, or potential risk are dealt with. To do this the internal auditor must be highly cognizant of department-wide issues and problems, as those are likely to provide the most significant results. Also, sufficient knowledge of the audit unit must be gained to determine what skill set is required to successfully perform the audit. The skill set must be sufficient to assure results while being careful not to overwhelm the audit assignment with either excessive quality or quantity of resources.

As to effectiveness, if it is accepted that department-wide policies, strategies and planning issues are at least as material as operational and administrative ones, and that department-wide issues, in general, are likely to be more material than local ones, then those concerns associated with higher level management should predominate. To satisfy these requirements the internal audit organization must be situated such that it can operate at the required level without restriction or interference by line management.

Reporting Relationship

The emerging trend for reporting relationships is the preferred one of having the audit head report to the deputy head. Alternative arrangements include reporting to a senior assistant deputy head (with no direct operational responsibilities) who in turn reports directly to the deputy head.

In cases where the reporting relationship is not directly to the deputy head there is usually a split provision for administrative and functional reporting. In this situation internal audit plans, reports and related issues would be expected to go directly to the deputy head, while strictly administrative issues would be dealt with by the immediate superior.

Another variation has both the heads of internal audit and program evaluation report to the same official, for technical and administrative purposes, who, in turn reports to the deputy head. The reason most often cited for the latter arrangements is the deputy head's excessive span of control.

A crucial determinant of the independence of the head of internal audit, and by extension of the audit group, is who carries out his/her performance review. Preferably, this is done by the deputy head, with advice from the audit committee.

Combining internal audit and program evaluation under one head has its advantages and disadvantages:

a) Advantages

1. Both functions are interested in departmental outputs and delivery mechanisms. Combining the two groups under one head facilitates coordinated/joint planning, exchange of data and of results.
2. In some departments the required skill set for auditors and evaluators overlap. A combined arrangement facilitates joint recruiting, rotation, secondment, etc., of human resources.
3. The two functions are sufficiently related that a senior executive can readily absorb them within his/her span of control while preserving most of the independence that would have been gained through reporting directly to the deputy head.

b) Disadvantages

1. Contact with the deputy head and other senior management may be impaired, or at least less direct.
2. Independence in auditing the Program Evaluation function may be impaired.
3. The priorities of one function may predominate over the other.
4. Where combined Audit and Evaluation Committees are established, instead of the more usual Audit Committee, the problems involved in arranging and running the associated meetings may become more complex.

In summary, there are potential advantages and disadvantages to such an arrangement. However, in those cases where span-of-control or other considerations mitigate against a direct reporting relationship, having the internal audit and program evaluation groups reporting through a position with responsibility for both may be a reason-

able compromise, provided reasonable precautions are taken to minimize the disadvantages listed above.

Personnel Management

Personnel management is essential to organizing. It includes classification, selection, recruitment, training and development, counselling and evaluation of performance of people to operate the organization competently. Good personnel management depends on good planning.

The number of auditors and range of skills is normally determined during the planning process. There are several diverse methods for obtaining the resource requirements identified. These are: hiring, promoting, training/developing, seconding, borrowing, rotating and contracting.

In any decision between the use of permanent and non-permanent staff, one typically faces the dilemma of striking a balance between organizational/operational familiarity, and independence. While seconded staff could provide program/functional experience otherwise missing in the audit group, it would be difficult to claim objectivity if the audit team was not led by an auditor who was independent of the operation or activity being audited. On the other hand auditors working under contract, while providing the audit group with both supplementary skills and resources and additional independence, are often perceived to be lacking in empathy and grounding in the organization under audit.

The solution to the problem of independence in the case of audit teams which include secondees and/or borrowed staff from the operations under audit, lies in the adequacy of supervision by a professional internal auditor. Essentially, this means using the secondee as an adviser who helps the auditor to ensure the completeness and integrity of the data used to describe the auditable unit, while relying on the auditor to perform the analysis and evaluation required to draw conclusions and to present the results to management. This approach minimizes the possibility of organizational bias, since the secondee is not required to judge performance but contributes to the audit team's greater understanding and allows for greater depth of coverage of the entity under audit.

An alternative in dealing with the problem of assembling audit teams with appropriate academic background and managerial/operational experience is rotation. This means choosing aspiring managers who could benefit from wider exposure for a rotation placement in internal audit, either unilaterally or in exchange for a senior auditor. This is a move which could be of mutual benefit to the audit group, the individual and the department in that it provides the audit group with needed operational and managerial experience thereby enhancing its credibility with auditees. Operations personnel gain valuable knowledge and experience in control theory and techniques, as well as a broadened knowledge of the organization. Auditors gain valuable operational and managerial experience. Last but not least, the organization as a whole gains a better trained, well-rounded cadre of managers.

In terms of the skills set of internal audit groups, the trend that is emerging is a combination of core auditors supplemented by a cadre of specialists in fields such as finance, personnel, administration, EDP. Skills most noticeably missing are usually management and operations related.

Core auditors are, and will tend to be for the foreseeable future, primarily individuals with accounting and financial backgrounds. The reason for this is that auditing has its roots in financial areas and the accounting profession has traditionally been the only group offering formal training in auditing. There are other alternatives emerging for acquiring internal auditing knowledge, including the preparation for and writing of the Institute of Internal Auditors' exams (i.e. acquiring a C.I.A. designation).

At present, there is no classification group that corresponds to, or includes completely the internal audit function. As a result, a number of groups and levels are currently in use. They include AU, FI, OM, AS, PE, CS, etc. Although there are conditions under which a case can be made for any of the groups listed above, some reflect the needs of the internal audit function more closely than others. Until a satisfactory permanent solution is developed, departmental internal audit groups faced with a classification problem should consult with the Office of the Comptroller General. One thing is certain, regardless of which classification group is chosen, the levels of the auditors performing, particularly leading, the current version of internal auditing should be at a higher classification level, than were its financial audit

predecessors, if they are to establish and maintain empathy/credibility with senior departmental functional and program management.

Recruitment

The head of the internal audit group faces a major task in attempting to recruit resources. With the expansion of the role of the internal auditor to perform audits of all departmental operations, it is difficult to find auditors who have adequate expertise in all areas. Thus, the director of the internal audit group must often hire staff with expertise in one of the areas subject to audit and then provide additional training for these individuals to equip them with audit skills. The reverse may also be true, where a person may be hired who has been an auditor but who needs further training in certain functional areas to enhance audit capability.

Orientation

Appropriate time and material should be provided for orientation of new staff members. Generally, the period of orientation will last anywhere from a few days to two weeks depending on the individual's familiarity with the organization. Anything beyond this is often non productive as the person becomes anxious to get on with an assignment.

Orientation should consist of:

- an overview of the structure and functions of government;
- an introduction to staff and, depending on the level of the new auditor, to members of management;
- a review of relevant documents and material including those pertaining to the department and to the internal audit function;
- an overview of the internal audit function's audit approach and processes including its methodologies, audit approach, philosophies, strategies, analytical concepts and techniques, use of work instruments such as

audit guides, programs, questionnaires, control records, etc. (An example of a departmental orientation package which could serve as a reference point for other departments interested in developing their orientation approach may be viewed in the OCG, Internal Audit and Special Studies Division library.)

Training and Development

To a considerable degree, training for internal auditors has traditionally been handled in an on-the-job fashion. Although experience has often been assumed to be the best teacher, it must be remembered that traditional auditing, mostly financial, was done within a well defined framework with relatively well-defined criteria. This is no longer the case, at least in the non-financial areas which currently comprise 80 per cent or more of the internal audit scope. With the greatly increased scope, plus increased and ever-changing technology, more government regulations and more complicated departmental activities, internal auditors cannot rely solely on experience to do their jobs adequately. Training and continuing education must be made available to members of the internal audit staff to ensure that as a minimum, all auditors have a sound understanding of the following:

- (a) the role and responsibility of internal audit;
- (b) the procedures and policies of the audit group and the manner in which they relate to generally accepted auditing concepts, including those of the C.I.C.A., the I.I.A. and those reflected in this Handbook;
- (c) management theory, practices and processes;
- (d) control concepts and practices;
- (e) analytical methods and techniques;
- (f) communication (interviewing, oral presentation, report writing);

- (g) the department's structure, objectives, programs, policies, operations, governing legislation, budgets, etc.; and
- (h) the many functional areas they may be expected to audit, including EDP.

To deal with the training that may be required to adequately acquaint each auditor with the above, it is incumbent upon the audit head to organize an appropriate training and development program. This means a formalized, structured approach to training and development; one that provides for an ongoing assessment of individual as well as organizational needs, a coordinated plan to facilitate the attainment of the desired training or development and a means by which to follow-up on the results.

The major objective of training is to increase the capabilities of individual staff members, such that they meet the requirements of their current assignments, and hence the effectiveness of the entire internal audit group. As such, it should be used strictly to upgrade staff caliber, not as a means to either reward good performance or fulfil some pre-conceived entitlement expectation on the part of staff members. It is a tool which must be used judiciously.

The kind of training needed by an individual auditor can be determined in a number of ways. The preferred method is to link the determination of training requirements with the requirements of the individual's assignments and with the performance appraisal process. This method offers an excellent opportunity for both supervisor and subordinate to discuss training in relation to requirements and subsequent performance. In other words, specific training objectives can be formulated during these meetings to address shortfalls in performance.

Training requirements may also arise as a result of specific audits to be carried out in the year ahead. For example, audit assignments requiring technical knowledge or expertise not currently available within the internal audit organization, or in short supply, could be dealt with by providing on-the-job training to those individuals who will be involved in such future audits. This can be done by "double banking" with in-house, or external (seconded, contracted) experts. Naturally, the advantages and disadvantages of pursuing this route as opposed to contracting out or seconding the necessary expertise would have to be evaluated.

Planning, guiding and directing the careers of the internal audit staff are important aspects of the role to be carried out by audit managers as well. To a large degree the head of internal audit may be evaluated by the degree of success he or she has in developing and upgrading staff members. Aside from providing a ready source for dealing with shortfalls resulting from attrition, staff members who are encouraged to develop in their profession are likely to be more highly motivated and effective in their current performance, provided that they see some potential for upward mobility.

An organizational environment which is, and is perceived to be growth oriented is more likely to be viewed as a desirable place to work by both incumbent and prospective employees. This desirable environment is supported by potential promotion opportunities. Promotion from within makes for good employee relations but it can breed sterility. An infusion of new blood can be revitalizing. A balance between the two is probably the best approach. To this end, it is desirable that departmental personnel planning provide for lateral mobility between internal audit and adjacent functions/positions.

4. THE INTERNAL AUDIT MANUAL

A departmental audit manual will serve the following purposes:

- to communicate policy, mandate, principles, concepts, processes, methods and techniques for internal audit adopted by the department or agency to provide direction through which the quality and efficiency of internal auditing may be maintained or improved;
- to provide a source of material for both formal and on-the-job training of internal auditors; and
- to provide and communicate standards through which meaningful performance measurement may be established within the internal audit function.

Much of the generic content could be transferred as is or adapted from this document (i.e., the IACIA Internal Audit Handbook), however, there will be material which is

unique to the department or agency involved which will have to be written specifically for the departmental audit manual. The nature and form of the internal audit group's management systems will be largely dependent on relevant departmental systems and so will not be described here in detail. Appendix A provides some examples which may be useful.

A suggested Table of Contents for a departmental audit manual is presented in Appendix B.

5. LEADING

A manager must make plans, develop the organization, systems and procedures and acquire resources necessary to carry them out. However, even if these functions are performed well, success is not assured. The manager must ensure that the staff carry out the plan to the best of their ability. This is the leading or directing phase of the job, and unless it is done well there will be a gap between plans and performance.

Leading embraces a wide range of activities from the straightforward task of issuing oral and written instructions to motivation, often involving considerations of great subtlety (e.g. providing guidance without stifling initiative).

Leading is a sub-function of management whose nature is heavily influenced by management style, which varies considerably from incumbent to incumbent. Therefore, no further elaboration will be attempted here. For those wishing to delve further into this area suitable references are provided in the Bibliography.

6. CONTROLLING

Control should be well understood and practiced by audit managers. In fact, the internal audit organization should serve as a model for good management practices within the organization. Unfortunately, this is often not the case. Audit managers, like other managers, get caught up in demanding work schedules, often with limited resources.

The internal audit manager or director must establish effective control over work activities. Building upon sound plans and organizational arrangements, appropriate systems and procedures, qualified people, and effective administrative direction, there must be a means of ascertaining whether resources are being utilized in the best way to meet goals and whether goals set out in the plans are being achieved. The audit manager must be sufficiently informed on the various ongoing activities to measure and appraise results, and have a basis for taking any necessary corrective action on a current and timely basis.

On the one hand, the audit manager wishes to avoid the kind of below-standard performance that would discredit the function. On the other, he or she does not want to discourage initiative, nor install control systems which are not cost effective. These objectives are accomplished principally through adequate, but not overbearing, supervision; regular and timely, but lean, progress reports; and critical post audit review and analysis of results, based on clearly established, predetermined standards which are demanding but not unreasonable.

The controlling process, in general, is no different for internal audit than for any other function. It may be summarized as three major activities for discussion purposes. (Rather than a lengthy discussion of general management principles, which are adequately covered in management literature and summarized in Volume II, Book 1, Chapter 4, Management Control Concepts, this section will focus on those control processes and procedures peculiar to management of the internal audit function.)

The three major activities are:

a) Develop goals/standards

The broader internal audit goals are normally expressed in the form of strategic and long-term plans, while specific goals and standards would be contained in the management plan and annual schedule in the form of audit assignments, and associated goals, standards and success criteria. As mentioned elsewhere in this Handbook, an internal audit group must develop a set of goals in its planning process, all subject to various control processes. Goals and plans serve the dual purpose of providing direction for implementation, and standards or norms against which to compare

results. The more specific the statement of goals and the associated plans, the better the yardstick by which to measure performance.

b) Measure and compare actual performance against intended results

Results of internal audit activities are subject to measurement at two levels, (1) individual assignments as per the annual schedule and (2) overall effectiveness of the function.

The first is basically a form of project control. It is accomplished by selecting strategic control points concerning the activity being performed. This would take the form of periodic progress reports and supervisory reviews at key dates or milestones. The assumption here is that a planning and control document (e.g. assignment planning memorandum, supervisor checklist and associated documentation) is adopted for each assignment or project undertaken by the internal audit staff, including both audit and non audit assignment projects in accordance with the annual schedule. Depending on the length of the assignment, and in addition to regular departmental reporting requirements, milestones should be established against which the audit staff must report progress relative to the approved plans. These milestones might be established at key points of the assignment e.g. completion of planning, completion of fieldwork, etc.

In addition to controlling activities and measuring results of individual audit assignments, internal audit managers must be prepared to contend with the larger issue of measuring the overall results of the internal audit activity. On the premise that the control function revolves around the goals to be achieved and the resources provided, the control mechanisms are oriented to overall effectiveness and the optimization of resource utilization. The comparison for actual performance against pre-determined criteria is intended to highlight any significant potential or actual deviations.

c) Analyze the cause of the deviations and take appropriate managerial action

When audit assignments are initially scheduled, the estimated person days are normally stipulated in an assignment memorandum. Based on the assigned number of personnel,

there are estimates of when the audit work will be completed, when exit meetings will be held, and when reports will be completed. As the job progresses, these estimates need to be re-evaluated in light of changing or unforeseen circumstances. The important point is that the control mechanism is able to flag these situations and in a timely manner provide the audit manager with useful and meaningful information as to the actual causes of potential or actual deviations between desired and actual performance.

By being apprised of and analyzing off-standard performance, whether it is time or quality of results, the manager is in a better position to plan future activities as well as make appropriate operating or personnel decisions. As an aid to current and future management decision-making all off-standard performances resulting in managerial action should be fully documented.

Effective control then is the necessary means by which good planning, sound organization, selective staffing, and a proper leadership are combined to produce intended final results. While the earlier phases of planning and implementation must be adequately developed, it is the control function that determines if a steady and orderly march toward the established goals is being achieved.

It is important to recognize that an effective control effort depends upon the careful design and effective utilization of the reports and procedures through which control is achieved. Good design of the specific control mechanisms is not enough. The second part of the effective control effort is appropriate use. This means prompt, vigorous and timely corrective action when deviations or other unfavourable developments are identified; but, the control system should be almost invisible otherwise. Almost, because the knowledge of its existence provides deterrent value, even when rarely used.

These procedures are particularly important for internal audit (as with all staff-like functions) because of the lesser operational pressures to which they are subjected, and the tendency, on the part of professionals, to pursue activities/results beyond the point of diminishing returns. It is useful therefore, for the audit manager, and in turn his/her total group, to reappraise periodically their approach to the control function.

Responsibility Centre Control

To be effective the Internal Audit manager must apply the above indicated control process in the same manner as any other manager in the organization. To a significant degree, this may be accomplished by utilizing the long term and annual plans, on the one hand, and the internal audit manual on the other, as means of achieving control over the audit group's results and activities respectively.

To appropriately control operations, the audit manager must measure the performance of the audit group on an ongoing basis. This means establishing mechanisms to measure not only the progress of particular audits or projects, but also the performance of individual auditors against predetermined criteria and standards of excellence, and the performance of the internal audit group as a whole.

The management information generated as a result of these kinds of comparisons will allow the audit manager to be in a position to take such decisions as are necessary to improve the overall economy, efficiency and effectiveness of the group. At the aggregate level, this information will provide the basis for accountability of the audit manager to the head of internal audit and of the head of internal audit to his or her superior.

Control mechanisms such as proper supervisory review at key points during the course of an audit; a clearing process for audit observations and audit reports; a performance evaluation system; and an accountability reporting system are invaluable to the head of internal audit, the audit manager and the team leader for the purposes of control.

For example, supervisory review of audits will help to ensure that working papers were prepared in the approved format, (i.e. properly indexed and cross-referenced), that all program steps were carried out or otherwise accounted for, and that all audit objectives were attained. Based on the assignment plan, the manager will be able to readily determine whether desired scope and depth of audit coverage was attained, whether audits in progress are on schedule, whether completed audits were concluded by their scheduled due dates and within the budgeted number of person-days and dollars, reasons for under/or overruns and their effect on the plans and schedules of the audit group.

In the following, a more detailed discussion is provided of three areas of responsibility centre control of particular interest to audit groups. These are Assignment/Project Control, Responsibility Centre Accountability Reporting and Evaluating Performance of Personnel.

(a) Assignment/Project Control

Assignment/project control consists, typically, of the following elements:

1. Assignment/project status reporting of utilization of resources (people/\$'s) against budget, at milestones which are keyed to specific task completion (i.e. results) targets. (Individual and aggregate, for each manager and for the head of the internal audit group.)
2. Weekly time sheet.
3. Quality control checklist for the various phases of the audit (as represented in the Working Papers). (At each level of review, i.e. team leader, manager, head.)
4. Assignment performance appraisals for all assignment team members (each appraisal to be performed by his/her superior).

Appendix A provides examples of each element listed above.

(b) Responsibility Centre Accountability Reporting

Accountability reporting refers to the management information, generated by various systems, which is available to a manager and enables knowledgeable decisions to be made. Depending on the individual manager, the system and its outputs may take many different forms. Many audit groups utilize, at a minimum, some form of weekly time reporting and status reporting system. Some of these are, of course, simply an aggregation or summary of assignment level control reports, however, there are others which deal with overall directorate economy, efficiency and/or effectiveness.

In devising control systems for the responsibility centre the design of the reporting systems should be tailored to the complexity of the environment and operations and to the needs of the individual manager. There is sometimes a tendency to try to provide for every conceivable contingency and in so doing the system becomes complicated and forbidding.

Such a system can collapse due to the demands it places on the audit staff, or simply from lack of use. On the other hand, in the more usual case the tendency is more to provide so little information, particularly on effectiveness, that it is of little use for directorate evaluation purposes.

Most effectiveness measures stop at the "output" rather than the "effects" level, i.e. audits completed or reports issued. This indicates that a result was produced, but gives no indication of its usefulness to management.

To be sure, criteria or standards for measurement of internal audit responsibility centres are typically not as explicit, and therefore as easily measured against, as those for control of audit assignments (eg. ensuring all audit program steps are carried out or otherwise accounted for). The internal audit manager must utilize a considerable amount of judgement in evaluating the extent to which criteria have been met.

The main ongoing process in an internal audit responsibility centre is auditing, which is adequately controlled through the assignment/project control process. The main focus of internal audit responsibility centre level control (performance measurement) is economy and/or efficiency and/or effectiveness.

The and/or notation simply alludes to the fact that, depending on the definitions one chooses, economy, efficiency and effectiveness may be considered as separate and distinct (i.e. mutually exclusive), or they may be considered as sub-sets each of the next higher order control. For example, efficiency may be defined such that it includes economy measures, and effectiveness may be defined globally to include economy and efficiency measures.

This latter approach has appeal from two points of view. First, it is difficult to imagine a process that is efficient and not economical; and similarly it is difficult to imagine a responsibility centre that is effective, in every sense (from the manager's point of view), if it is not also economical and efficient, since the manager's performance depends on all three.

Admittedly one can be "doing the right thing" and not "doing it right", to quote an often used definition. However, although this narrow definition may suffice for evaluation of a process or result, in isolation it is not very useful in the complete evaluation of a responsibility centre's performance, or that of its manager. A manager who does the right thing but does not do it right is simply not an effective manager.

Second, it provides for segregation of lower level or proxy measures if adequate criteria cannot be developed for the next higher level while recognizing their inherent relatedness. For example, if output measures are not measurable then one can still use input (economy) measures, in terms of budgeted versus actual resources used. On the other hand, if efficiency measures are feasible the input (economy) measures are readily absorbed into combined efficiency indices.

A list (not exhaustive) of possible measures for each of economy, efficiency and effectiveness (the 3 Es) are presented in the following pages, with both the global and narrow definitions for the 3 Es represented.

Economy Measures (E_1)

<u>Measure</u>		<u>Definition Represented</u>
1.	$E_1 = \frac{\text{Input Used}}{\text{Input Planned}}$ (Assumes that the plan is correct). Where Input = Person-days or \$'s or other resource.	Both
2.	Min. $E_1 =$ Cost of resource acquired, while meeting quality requirements.	Both
3.	Min. $E_1 =$ Cost of maintaining resources, while meeting quality requirements.	Both

Efficiency Measures (E₂)

<u>Measure</u>		<u>Definition Represented</u>
1.	$E^*_2 = \frac{\text{Output}}{\text{Input}}$ or $E_2 = \frac{\text{Benefits}}{\text{Costs}}$ Where: Output/Benefits = Inputs/Costs = Note: *	(Assumes that output can be (a) adequately defined or (b) held constant; to be meaningful this ratio should be compared to an absolute (ideally) or at least a relative standard, e.g. previous period or other similar RC). Audits/Reports/Findings/Findings Accepted/recommendations implemented/savings identified/etc. Caveat: some legitimate audit findings/recommendations result in higher costs in the short-term; presumably for cost or performance gains in the long run. Person-days or \$'s. This ratio is sometimes called "productivity, particularly when used in macro-economic terms.
2.	$E_2 = \frac{\text{Productive Input}}{\text{Input Available}}$ (Usually used for purposes of measuring human resource utilization as compared to a pre-determined standard/objective.)	Narrow
3.	$E_2 = \frac{\text{Input available for assignment}}{\text{Theoretically Available Input}}$ e.g. For human resource; indicates the effect of sickness and other absence on availability.	Narrow

Effectiveness Measures (E₃)

1.	$E_3 = \frac{\text{Output Achieved}}{\text{Output Planned}}$	Narrow
2.	$E_3 = \frac{\text{Effects Achieved}}{\text{Effect Planned}}$	Narrow
3.	$E_3 = \frac{\text{Effects Achieved}}{\text{Output Achieved}}$ (Actually a form of output efficiency, in the economist's sense)	Narrow

4. (Includes achievement of all indicators of success that were planned). Most global

$$E_3 = \frac{\text{Effectiveness Achieved}}{\text{Effectiveness Planned}}$$

i.e. Degree to which the RC achieved what was planned for the RC; or what the manager achieved of what was expected, in the MBO sense).

Output = (Similar to that defined under "efficiency measures").

Effects = Findings/recommendations accepted/recommendations implemented/benefits obtained by management from recommendations implemented; i.e. the degree to which the auditee/dept. is better off as a result of the audit performed.

Caveat: Although these indicators (i.e. E_3 s) are theoretically the most representative of the effectiveness of the IA function they are very difficult to use for two reasons:

- a) They are often difficult to measure, particularly if they result in better service rather than in lower cost; sometimes they result in higher costs.
- b) The responsibility for the better performance is at best, shared.

Effectiveness = Meeting of all the goals/standards/etc.,
(for RC/Mgr.) set for the RC or manager or both.

(c) Evaluating Performance of Personnel

Audit staff require regular evaluations to let them know how they are doing. To be effective, these evaluations should be fair and held frequently. They should be carefully structured and be carried out according to an established, consistent, and well-understood pattern.

Internal auditing provides its own uniqueness in evaluating staff people. No two projects are the same. Some projects may not be challenging to an auditor. Others may turn out to be beyond an individual's potential or experience. Still other projects, which had previously been performed in a routine and

unimaginative fashion, may be made more interesting because of an auditor's novel approach or innovative methods. All these factors should be considered in structuring the evaluation system so as to be fair to the employee as well as the department.

To measure anything reasonably well requires objective standards and consistent methods of gauging performance. All persons who will be evaluated should be fully aware of the standards and the methods. Thus, the policy or program should be clearly communicated. The instructions should make clear what is considered excellent, adequate, or unsatisfactory performance. The instructions should also establish when and how often the evaluations will be made and how they will be used. It is considered good practice to have evaluations performed at the completion of each assignment with a roll up at least once a year, for the annual appraisal. (See Assignment/Project Control and Appendix A).

The size of the auditing organization also has a significant bearing on how the evaluation program will be structured. A director of auditing with six people would have less difficulty conducting frequent and informal performance evaluations. A larger organization, with several supervisors and a large number of in-charge auditors and assistants, precludes close contact between the auditors and the director. In this environment, it is the supervisors who have the personal contact with the auditors-in-charge, while the latter have the contact with their assistants. And the greater the number of supervisors, the more remote the possibility that all evaluations in the department will be carried out in the same way.

In the case where an Internal Audit director does all the evaluations he/or she can be completely open with staff about precisely how they were rated. When staff are subject to the review of different supervisors or auditors-in-charge during the year, the director should be careful about letting the evaluators have the last word. Different supervisors and different auditors-in-charge will most likely have varying standards, likes, dislikes, and prejudices.

One evaluation program that has worked reasonably well provides the following pattern:

- At the conclusion of each audit assignment, the auditor-in-charge prepares a rating sheet (see Appendix A - for illustrations) for each of his assistants, and the supervisor or manager prepares one for the auditor-in-charge. A rating for each assignment is necessary because of the variations among assignments. The actual ratings are not discussed, but a dialogue is conducted on the strengths and weaknesses observed on that particular project.

This dialogue can be extremely beneficial, depending on how it is approached. An often successful method is for the evaluator to open the conversation by asking the subordinate to assess his or her own performance e.g. what was done well, what was done poorly, what was learned from the job, and what are the areas for improvement. This kind of dialogue can provide an invaluable learning experience for the employee and would be followed by the manager's views.

- At the end of a 6-month or 12-month period, the head of Internal Audit combines the various ratings and discusses the results with each auditor. These ratings and interviews are of major importance to the individual. In large organizations, this may be the only time during the year when the auditor has a chance to have an unhurried open discussion with the director. These should be carried out in a relaxed manner and result in a thorough review of the auditor's problems, goals and aspirations, and in a program to work them out.

In filling out the rating sheets, the evaluator should seek to maintain a distinction between accomplishments and traits. While both are significant, each has a different function. The rating of accomplishments should apply to the particular project completed, since each project has different problems. The evaluation of traits deals with the qualities that auditors carry with them through their

working lives. Traits are harder to evaluate since the evaluator is applying subjective standards; they are also harder to change. However, it is well for the head of Internal Audit to be aware of significant traits since they may affect decisions about an auditor. For example, a project which requires a large number of assistants should not be assigned to an auditor who, because of his/her introversion, has been unable to demonstrate an ability to supervise.

The internal auditor combines technical competence and education with such personal traits as adaptability, understanding, integrity, determination and interpersonal skills. Thus, the head of internal audit must maintain a well-structured employee evaluation program to inform the auditor of progress, strong points and those areas where improvements can be made.

Finally, it should be kept in mind that an appraisal may be as much an evaluation of the auditor's supervisor as of the auditor.

Evaluation of the Audit Function

As is the case with every other function or activity within an organization, the internal audit function is subject to evaluation. The process should review not only performance but also the criteria used to measure performance. In the case of the internal audit process, the criteria take the form of the Standards for Internal Audit in the Government of Canada; criteria for evaluation of operational performance are supplied by operational and assignment plans. The former serves as a kind of benchmark against which to judge the administrative performance of the audit group, while the latter is useful in assessing the extent to which the audit group was effective in carrying out its plans. The judgement as to the overall effectiveness of the internal audit group is essentially subjective in nature. It is ultimately made by the deputy head and reached after considering feedback received from various sources including the following:

Office of the Auditor General Reviews: As part of the review of a particular department or as part of a government-wide audit, the OAG may review the internal audit function.

Office of the Comptroller General Reviews: As part of the effort to upgrade the quality and effectiveness of internal auditing in the Government of Canada, performance monitoring is carried out by the OCG.

Outside Party Review: In an effort to determine its strengths and weaknesses and thereby improve performance, departmental heads may turn to outside parties such as private sector consulting/auditing/accounting firms to conduct performance reviews.

Management: Feedback could be obtained from senior management and the audit committee concerning management's perception of the function. This kind of feedback can be extremely beneficial and informative for appraisal purposes, in that it indicates the extent to which the role and activities of internal audit are appreciated and accepted by the organization's management. This, however, should never be the sole determinant of the audit functions performance, simply because the more significant the audit findings the more affected and less objective the auditee managers.

Accountability Reporting Systems: As previously described, in the "Responsibility Centre Control Section", the internal audit manager establishes control mechanisms to monitor the performance of the audit group. Similarly, he or she participates in the feedback or control mechanisms of the deputy head. In this respect the Standards indicate that "a report shall be submitted to the deputy head at least annually on audit coverage, major findings, significant unresolved recommendations and any other matters requiring the deputy head's attention." Furthermore, they indicate that "the internal audit group should assess whether appropriate follow-up action on the implementation of recommendations, has been taken and it should report inadequate action."

There is probably no greater indicator of the effectiveness of the internal audit group than the extent to which its recommendations are implemented and prove beneficial to the auditee, and the department as a whole. Therefore, it is important that the head of internal audit track responses, observations, recommendations and action plans all the way to implementation to be in a position to adequately gauge the overall effectiveness of the internal audit group.

The above kinds of feedback are essential to the Deputy Minister, for purposes of departmental management decision-making, and present an opportunity for the audit manager to demonstrate the effectiveness of the internal audit function as well.



APPENDIX A

ACCOUNTABILITY REPORTING SYSTEM

1. STATUS REPORT

General

The status report, a sample of which is shown in Figure A is a multiple purpose control document that provides the audit assignment control system with the following information (abstracted from NH&W's Internal Audit Manual; and adapted with permission):

- (a) Notification that an audit has been initiated;
- (b) Planned time utilization on the audit (by phase);
- (c) A revision or update of the audit plan;
- (d) A weekly progress report on the audit;
- (e) Notification that the audit is complete; and
- (f) Cumulative history of the audit.

Whenever an audit is assigned, the audit team leader will create a status report. This document is retained by the team leader for the duration of the audit. It is used for periodic activity reporting through the audit control system and becomes a permanent historical record of the audit from initiation to completion.

In the case of a non-audit assignment or project, the development of audit programs for example, a status report is created at the discretion of the manager. A straight-forward assignment of short duration does not warrant the same control as a long multi-phase audit, a status report would therefore not be created. As a guide, status reports should be created for assignments with an estimated labour content of one person-month or more. Special project numbers are secured from the administration clerk for all projects.

Completion Procedure

(i) Initiation

Header information: Enter the following at the top of the report:

- a. Issue: numbered serially starting at no. 1 and date
- b. Date: calendar date of original preparation
- c. Auditor: name of responsible team leader
- d. Audit Number: identifying number of the audit or project
(obtained from the administration clerk)
- e. Audit Title

(ii) Planning information

Planning information is entered as follows:

- a. The following audit phases will be used for time reporting by phase:

PHASE A	-	Assignment Planning
PHASE B	-	Review
PHASE C	-	Evaluation
PHASE D	-	Verification
PHASE E	-	Reporting

- b. Est. Person-days: estimated number of person-days required by phase.
- c. Start-P: planned starting date of the phase.
Start-A: leave blank until the actual completion date can be entered.

- d. **Stop-P:** planned completion date of the phase.
Stop-A: leave blank until the actual completion date can be entered.
- e. **Week ending:** enter the appropriate week ending (Friday) date in the block at the head of each column; in Figure A the first week of project activity was 7 Oct.
- f. The duration of each project phase is shown opposite the phase designator/person-days/start/stop information in Gantt chart fashion. Bold vertical lines mark the beginning and ending of a phase as shown in Figure A.

Recording Weekly Progress

Preparation

An updated project status report showing progress achieved during the week is to be submitted for active audits and projects. The updated reports shall be given to the appropriate manager and to the administration clerk by Friday noon of each week during Phases A, B,C and D of the audit. To record weekly progress, proceed as follows, while referring to Figure A Internal Audit Status Report:

- a. On schedule: If the weekly progress is according to plan, enter a check mark () in the week-ending box opposite the appropriate phase.
- b. Behind schedule: If the weekly progress has not met the planned estimate and the work has fallen behind, enter the number of calendar days that the work is behind the planned estimate and circle the number - see Figure A. Enter an explanatory note concerning the delay in the notes block.
- c. Ahead of schedule: When weekly progress has exceeded the planned estimate enter the number of calendar days that the work is ahead of schedule in the week-ending box. Enter an explanatory note, if appropriate, in the notes block.

Distribution

Photocopy the updated status report, enter the end week date on the photocopy and give copies to the appropriate division chief and to the administration clerk; retain the original.

Revision and Update

Revision

When an audit plan is altered, for whatever reason, the audit assignment control system must be informed. The medium for so doing is a revised status report. If the changes to the existing status report are few, the old information can be obliterated with typewriter correcting fluid and the new data entered. If the changes mean extensive alteration of the existing status report, proceed as follows:

- (1) increment the issue number;
- (2) enter the date of the status report revision;
- (3) in the notes block, enter a brief explanation of the reason for the revision;
and
- (4) make a photocopy of the revised document and forward it to the
administration clerk and division chief.

It is good practice to place a copy of the old status report on the audit file for future reference.

The following rules of thumb should be used for determining when an audit phase should be rescheduled:

- (1) if the elapsed time between start and finish of a planned audit phase is changed by 20 per cent or more; or

- (2) if the estimated labour input to a planned audit phase is changed by 20 per cent or more.

The audit phase in question, and consequently all succeeding phases, shall be rescheduled instead of proceeding with the original schedule plan and reporting days early or late.

The following procedure shall be used when beginning a new audit phase after finishing the previous one late:

- (1) if plans for the subsequent phase had not been included on the status report on late completion of the previous phase:
 - incorporate the labour and time estimated for the new phase on the report to reflect late completion of the preceding phase;
 - enter planned start and finish dates for the new phase;
 - enter the actual start date (assuming the new phase is to start immediately);
 - start the new phase "on schedule".
- (2) If the subsequent phase has been included on the status report on late completion of the preceding phase:
 - erase the bold vertical lines that depicted the original plans for the phase;
 - place a revised set of bold vertical lines at the start and finish points of the newly scheduled phase that account for late completion of the preceding phase;
 - enter the actual starting date in the appropriate column (assuming the new phase is to start immediately);

- start the newly planned phase "on schedule";
- note that the original planned start and finish dates of the phase are not altered;
- adjust subsequent phase plans as required.

The foregoing, can be adapted to situations where audit phases are completed ahead of schedule.

Extension

In many situations one cannot foresee how an audit will proceed from the outset. In such situations, the initial plan, and therefore the status report, will contain estimates of the initial one or two phases only. As these phases approach completion the team leader shall add estimates of the remaining phases and enter an appropriate note in the notes block to record the date of so doing.

Completion

(1) Introduction

In the week an audit is completed, the team leader will notify the control system by first entering activity information in accordance with the foregoing instructions. Secondly, he/she will enter "AUDIT COMPLETED, DATE" in the notes block. He/she will then give it to the administration clerk and manager. Audit completion is signified by notification from the auditee that the audit report in question has been received and accepted.

(2) Cancellation and Suspension

If an audit is interrupted or terminated at some point, and audit effort temporarily ceased, the appropriate entry shall be made in the notes block:

- (i) CANCELLED with reasons for cancellation - if the audit is terminated prior to completion, not to be re-initiated.
- (ii) SUSPENDED with reasons for suspension and date of expected re-start - if the audit is temporarily suspended, when the audit is re-started, a "RE-START" entry should be made in the notes block.

2. WEEKLY TIME SHEET

The following has been asbtracted from NH&W's Internal Audit Manual, with permission:

General

All audit staff must submit a weekly time sheet to the administration clerk by Friday noon of each week. The time sheet data which summarizes how the individual occupied his or her time during the week is coded and entered into the audit control system to produce audit cost data. The report must include data for each weekday, including statutory holidays, in one-quarter day portions.

Completion Procedure

The time sheet is completed as follows:

- a. The date, name, and initials are entered at the top of the sheet. Note that the date block is for Friday's date. Refer to Figure B.
- b. Audit related data is entered on the lower portion of the sheet as follows:

(1) Activity Code

An appropriate activity is selected from the activity code list on the bottom of the sheet and is entered in the three-space activity block.

(2) Audit Code

A three-digit audit or special project identifier is entered in the three spaces of the audit number block.

(3) Phase Code

Select the appropriate phase identifier from those listed on the right-hand side of the sheet, and enter in the space provided in the phase code block.

(4) Labour Expended (quarter days)

The number of quarter days of labour expended on the identified activity, entered as above, is recorded against the appropriate day(s) of the week.

Summary Print-Outs

The output of the time reports submitted is a computer print-out which is analyzed for the director by the administration clerk. The actual time spent on audits/projects can then be compared to the estimated time on Status Reports.

3. DIRECTOR'S MONTHLY STATUS REPORT

The following has been abstracted from NH&W's Internal Audit Manual, with permission:

General

At the end of each calendar month, the assistant director and the division chiefs report to the director on the status of audits and projects that are in progress or suspended. The report form is shown in Figure C.

Figure 4

STATUS REPORT -									
Date		Title - Type		Team		Project Number - Check of equipment		Team	
27 Sept. 82		Combined Audit - Records Services Division		Joe Black		25 Nov. 82		Week Ending Friday - Summary Entries	
Audit No. - No de la vérification		718		Bill Smith		Ed Brown			
Phase	Start - Début		Completion		Issue - Publication	Date	JAN	FEB	MARCH
	Planned Previous D.M.-Y J.M.-A	Actual Realité D.M.-Y J.M.-A	Planned Previous D.M.-Y J.M.-A	Actual Realité D.M.-Y J.M.-A					
A	3 Oct	3 Oct	14 Oct	14 Oct	7 14 21 28 4	NOV 11 18 25 2	DEC 9 16 23 30 6	JAN 13 20 27	
B	17 Oct	17 Oct	18 Nov	18 Nov	✓	✓			
C	14 Nov	18 Nov	2 Dec		✓ (2) 11	✓			
D	29 Nov		16 Dec		✓ (4) 19				
E	22 Dec								
Total est. and Actual Person Days Total estimatif et réel des jours-personnes									

No. 9.

- 28 Oct - No problem, will catch up within 2 weeks
4 Nov - Will be on schedule by next week
18 Nov - Late getting started on "C" - may be able to make it up
25 Nov - Ed off sick all week, no return date shown - let's discuss a reschedule

Reporting Procedure

On the first working day of each month, the administrative assistant provides the assistant director and the managers with a copy of the previous month's report. This copy is updated to reflect correct audit and project status and is returned to the administrative assistant for typing and distribution to the director, the assistant director and the managers prior to the seventh working day of the month.

Report Format

The report comprises six columns (see Figure C) into which audit and project information is entered as follows:

Audit/Project: The title of the audit or project as it is stated in the audit control system is entered into a block in the first column.

Team: The names of the audit or project team leader and members are entered in the second block.

Starting Date: Enter the date on which the work actually began.

Estimated Completion Date: Enter the estimated completion dates of Phases C and D of the audit. The events that signify the end of these two phases are described earlier in this chapter. Once the two estimates have been made and entered into the report, they are not to be changed. Revisions to schedule are to be shown on the project status report, not in the director's monthly status report.

Actual Completion Date: Enter the actual completion date of Phases C and D, as they occur.

Remarks: Any remarks required for explanation of the information entered as above can be included in the remarks block.



Health and Welfare Canada
Internal Audit Directorate

Santé et Bien-être social Canada
Direction de la vérification interne

I.A.11

WEEKLY TIMESHEET — FEUILLE DE TEMPS HEBDOMADAIRE

Figure B

Week ending Friday
Semaine se terminant
vendredi le

D - J	M	Y - A
01		06

SURNAME — NOM DE FAMILLE													
07													22

INIT.	
23	25

ACTIVITY CODE CODE D'ACTIVITÉ			AUDIT NUMBER NUMÉRO DE LA VÉRIFICATION				PHASE CODE CODE DE PHASE	QUARTER DAYS — QUARTS DE JOUR							CONTROL CLERK USE À L'USAGE DU COM- MIS DE CONTRÔLE		47
26		28	34			37	38	S-S	S-D	M-L	T-M	W-M	T-J	F-V	45	46	
										40							
			A														X
			A														X
			A														X
			A														X
			A														X
			A														X
			A														X
			A														X
			A														X
			A														X

Activity codes with an * require audit number/
phase code.

Les activités marquées d'un * demandent le n°
de la vérification / code de phase

EMPLOYEE'S SIGNATURE — SIGNATURE DE L'EMPLOYÉ(E)

ACTIVITY CODES — CODES D'ACTIVITÉS			PROJECT PHASE CODES CODES DE PHASE DU PROJET	
000	ANNUAL AND STATUTORY LEAVE CONGÉS ANNUELS ET STATUTAIRES	*201	A	PROJECT PLANNING PLANIFICATION DE PROJET
002	SICK LEAVE CONGÉS DE MALADIE	*500	B	FIELD WORK AND ANALYSIS TRAVAUX PRATIQUES ET ANALYSE
003	COMPENSATORY LEAVE CONGÉS COMPENSATOIRES		C	PRESENTATION AND DRAFT REPORT PRÉSENTATION ET ÉBAUCHE DE RAPPORT
004	ALL OTHER LEAVE AUTRES CONGÉS	600	D	FINAL REPORT RAPPORT FINAL
100	LANGUAGE TRAINING COURS DE LANGUES		E	DEVELOPMENT OF WORK INSTRUMENTS PERFECTIONNEMENT DES INSTRUMENTS DE TRAVAIL
101	TRAINING FORMATION	701		
102	TRAINING - DEPARTMENTAL FORMATION - MINISTÉRIELLE			

Figure C

AUDITS/PROJECTS STATUS REPORT AS OF

RESPONSIBILITY OF:

AUDIT/PROJECT	TEAM	STARTING DATE	ESTIMATED COMPLETION DATE	ACTUAL COMPLETION DATE	REMARKS

4. QUALITY CONTROL

Quality Control of assignments is typically carried out by examining the working papers. The following pages contain an example of a "checklist for reviewers".

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
------------------	--------------------------

Assignment title _____

PART I (to be completed by Chief/Audit Manager)

Assignment Planning Phase

1. Does the audit planning memorandum set out:
 - broad objectives of the audit related to Terms of Reference provided to Team Leader;
 - specific activities to be audited (including an overview flowchart if applicable);
 - audit methodology;
 - supervisory review requirements;
 - budget of staff-days and other resources in sufficient detail to be useful as a control device;
 - any other matters, (e.g., restraints on availability of auditee and audit personnel, dependence or other auditors, etc.);
 - responsibility for the drafting of audit report?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
------------------	--------------------------

Assignment title _____

2. Is the estimate of resources required per the planning memorandum in sufficient detail to act as an effective control over each audit phase?

Does the estimate of resources needed identify:

- the level of skills required;
- specialized skills, e.g. software support;
- amount of total resources needs to be filled by professional services;
- travel requirements - dollars and time?

3. Do the activities selected for audit warrant examination in the light of the information contained in the working papers relating to known weaknesses, materiality and any other matters?

4. Does the information in the working papers support the audit methodology selected?

5. Has a plan/structure been prepared for the working papers for the subject assignment?

6. Has there been communication with the auditee in preparation for the review phase of the fieldwork?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
<u>The Review Phase</u>		
1. Do the working papers include notes of preliminary meeting with auditee manager?		
2. Do the notes of the preliminary meeting show that the auditee is aware of: <ul style="list-style-type: none">- planned objectives and scope of audit assignment;- the audit approach;- clearance procedures for observations;- clearance procedures for audit reports;- timing of audit;- the need to inform auditee staff of the auditor's right of access to information and cooperation?		
3. Do the notes of the preliminary meeting contain information on: <ul style="list-style-type: none">- the activities in each organizational element under review;- problem areas which auditee wishes to be reviewed;- systems revisions or studies under review in area?		

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

YES/NO
OR N/A REFERENCE OR
COMMENTS

Assignment title _____

4. Has the information obtained from the preliminary meeting with the auditee manager been taken into account in revising and setting out in the audit assignment memorandum:
 - the activities selected for audit;
 - the audit approach;
 - the estimates of resources required?
5. Was a predetermined control model developed if one did not exist at the beginning of the assignment?
6. Have the auditees systems and processes been documented and validated?
7. Has a limited review of the auditee's controls been carried out, and potentially significant audit issues identified?
8. Has an evaluation plan been prepared?

Evaluation Phase

1. Do the working papers show that the control framework under review has been adequately documented in the Review phase?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
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Assignment title _____

- 2. Do the working papers contain evidence of the limited verification of documentation in the Review phase?
- 3. Do the working papers show that an evaluation has been done of any environmental controls within which the system operates?
- 4. Has the impact of the environmental controls been taken into account in assessing the apparent deficiencies in the control framework?
- 5. Have all questions on the standard control questionnaires or checklists, used to evaluate the financial control framework been answered, (e.g. CICA guides and FitzGerald matrices).
- 6. Does any control questionnaire need amendment?
- 7. Do the working papers identify those areas where there is great potential exposure?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
8. Do the working papers:		
- identify the essential controls, significant weaknesses or deficiencies and the major inefficiencies in the financial control framework examined;		
- document the identified essential controls, significant weaknesses and deficiencies, etc., in the		
- Register of Key Controls;		
- Register of Control Weaknesses and Inefficiencies?		
9. Do the working papers, namely the Register of Key Controls and the Register of Control Weaknesses and Inefficiencies, indicate the nature of the control or deficiency and the materiality of the deficiency?		
10. Where the control questionnaires indicate that there are compensating controls are these set out separately?		

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
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Assignment title _____

11. Were needs for verification identified and verification plans/programs developed where needed?
12. Was a cause-effect analysis performed and documented for each material or significant finding?
13. Were preliminary audit findings, conclusions and proposed recommendations developed and documented?

The Verification Phase

Prior to Exit Interview

1. Were the objectives of each verification step clearly defined prior to the development of an audit program?
2. Do the working papers show that the verification steps used, included in the audit program, were properly planned with a view:
 - to verifying that key controls are operating as designed and are effective;
 - to substantiating significant deficiencies and major inefficiencies, assessing their effect, and identifying their root causes?

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
------------------	--------------------------

Assignment title _____

3. Do the working papers show that any additional significant deficiencies and major inefficiencies disclosed during the verification of essential controls were subject to the same verification as those originally identified in the Evaluation phase?
4. Do the working papers confirm effective operation of essential controls and indicate:
 - materiality of any errors found, i.e. risk of loss, nature of transaction, and the volume of the system;
 - confidence levels of findings;
 - results of verification steps?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
5. Do the working papers substantiate the existence of significant deficiencies and major inefficiencies noted and show: <ul style="list-style-type: none">- the causes;- the potential effects;- details of the results of the verification steps?		
6. Do the working papers substantiate all observations to be discussed at the exit interview with the auditee manager?		
7. Do the working papers indicate where findings could be substantiated with qualitatively better or more reliable evidence which has not been obtained because of additional costs (i.e. a diminishing returns decision was made)?		
8. Do the working papers indicate the estimated cost of the qualitatively better or more reliable information to support the audit findings?		

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
9. Do the working papers indicate that the auditor-in-charge has exercised proper supervision over audit staff carrying out the audit assignment by initialling each page?		
10. Are the list of observations to be discussed at the exit interviews with the auditee manager indexed to the working paper file?		
11. Do the working papers indicate major deficiencies or other significant findings requiring presence of chief at exit interview with auditee manager?		
12. Do the findings indicate a necessity for exit interviews at management levels other than the auditee manager?		
13. Have minor findings cleared at lower level and not to be reported further been adequately substantiated?		

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
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Assignment title _____

After Exit Interview

1. Have the facts of all findings of the audit been verified and discussed with the auditee manager at the exit interview?
2. Has the initial reactions of the auditee manager, to the audit findings discussed at the exit interview, been noted in the working papers?
3. Have the major findings, (both positive and negative) of the audit been identified for inclusion in the audit report?
4. Has an outline of the form and content of the audit report been prepared?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
<u>Assignment Report Phase</u>		
<u>Draft Report</u>		
1. Does the report meet the criteria set out in section on Report Writing regarding: <ul style="list-style-type: none">- format;- contents;- provision of a record against which corrective action can be measured;- communication of results to appropriate officials?		
2. Does the report set out the objectives and scope of the audit and relate the findings, conclusions and recommendations to those objectives and scope in a logical manner?		
3. Does the summary of findings and conclusions relate to the objectives of the audit?		

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
4. Does the summary of findings, (both positive and negative) and conclusions present an accurate synopsis of the findings etc., contained in the main body of the report, and is the level of presentation commensurate with the level to which the summary is being targeted?		
5. Are all findings and recommendations in the report supported by the working papers?		
6. Is adequate account taken of corrective action already initiated by the auditee?		
7. Is the file copy of the report in the working papers referenced to the working papers?		
8. Does the report include a section on the extent and effectiveness of corrective action taken on observations and recommendations included in <u>preceding</u> audit reports?		

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
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Assignment title _____

9. Have all observations and recommendations in the report been fully discussed with the auditee managers including, where appropriate, functional managers?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
------------------	--------------------------

Assignment title _____

Final Report

1. Has the proposed distribution list for the report been reviewed to ensure that all interested parties, both line and functional, receive copies of the report?
2. Does the report include the comments on the findings, conclusions and recommendations included in the report, by:
 - the auditee and functional managers;
 - the senior management of the auditee and functional managers?
3. Have all changes to the draft report been cleared with the:
 - auditee manager and functional managers;
 - senior management of auditee and functional managers?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
<u>Final Review</u>		
1. Have all questions in the audit programs been answered satisfactorily?		
2. Have all outstanding items in the working papers been cleared as:		
- not material and only reported verbally to auditee managers at exit meeting;		
- significant and included in audit report;		
- items for follow-up at next audit?		
3. Have those parts of the audit plan completed by audit agents been reviewed in the light of:		
- the agent's contact of audit services to be supplied;		
- the agent's audit report on the area audited?		
4. Have the working papers been fully indexed and adequately cross-referenced?		
5. Is the "Permanent" file properly maintained?		

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
------------------	--------------------------

Assignment title _____

Quality Control

1. Does the review of working papers and audit report show that the Branch's standards have been adhered to?
2. Do the working papers show evidence that efficient and effective use has been made of the audit staff (both in-house and contract) for purposes of the audit?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
<u>Audit Staff</u>		
1. Do the working papers show evidence of proper supervision of audit staff during audit?		
2. Have all performance review reports for audit staff been prepared and discussed with them?		
3. Do the written evaluations identify a need for further staff training, either: - on the job, or - formal training?		
COMPLETED BY _____		

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
Assignment title _____		
<u>Budget of Resources</u>		
1. Has the budget/time summary been completed to date?		
2. Have variances between budget and actual been satisfactorily explained?		
<u>Follow-Up</u>		
1. Do the findings of the audit show need for further review:		
- in other areas of financial administration not presently being audited;		
- in future audits of the same area?		
2. Have all significant findings of a permanent nature been noted in the permanent audit file?		
3. Has a proposed follow-up plan been developed? (Subject to input/approval by the Audit Committee.)		

COMPLETED BY _____

CHECKLIST FOR REVIEWERS

Section 320

	YES/NO OR N/A	REFERENCE OR COMMENTS
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Assignment title _____

Part II - (To be completed by Director, Internal Audit)

Assignment Planning Phase

1. Do the objectives of the audit assignment as set out in the planning memorandum, complement the long term and annual plan of audit for the Branch?
2. Are the following, as set out in the planning memorandum, acceptable as a basis to meet the objectives of the audit:
 - the specific activities selected for audit;
 - the audit approach selected;
 - the estimate of resources needed?

COMPLETED BY

CHECKLIST FOR REVIEWERS

Section 320

YES/NO OR N/A	REFERENCE OR COMMENTS
------------------	--------------------------

Assignment title _____

Final Review

1. Were the approaches to the audit, the selection of activities audited and the performance of audit staff satisfactory in the light of the planned objectives of the audit and the audit results achieved?
2. Has our work been in accordance with:
 - the mandate of the Branch;
 - professional standards and Branch quality control?
3. Are the observations and recommendations in the final report fully documented in the working papers?
4. Have all outstanding matters been reviewed and cleared with auditee managers?
5. Has the chief's supervisory review checklist been completed satisfactorily?

COMPLETED BY

5. PERFORMANCE APPRAISALS

Procedure

As audits are completed, team leaders should appraise the performance of each team member. At annual appraisal time the director and assistant director/manager consolidate the contents of all audit appraisals from the preceding fiscal year into an annual appraisal which is filed in the individual's departmental personnel file. The collection of audit appraisals is then destroyed. In the same manner as team leaders appraise the performance of their team members, the division chiefs/managers appraise the audit performance of the team leaders.

In the following pages three examples are provided, with permission (some slightly modified). The sources are:

1. DRIE, Internal Audit Group
2. NH&W, Internal Audit Directorate, Internal Audit Manual
3. DSS - Services, Audit Services Bureau



Government
of Canada

Gouvernement
du Canada

Regional Industrial
Expansion

Expansion industrielle
regionale

AUDITOR PROJECT APPRAISAL

ÉVALUATION DE PROJET DE VÉRIFICATEUR

I.A.36

Auditor's Name – Nom du vérificateur	Classification	Time charged to Audit – Temps chargé à la vérification
Description of Audit Assignment – Description du projet de vérification	Project No. – N° de projet	

		see definitions below Voir les définitions ci-dessous			
		Unsatisfactory Insatisfaisant	Satisfactory Satisfaisant	Fully Satisfactory Entièrement satisfaisant	Superior Supérieur
AUDITING CAPABILITY	APTITUDE À FAIRE DE LA VÉRIFICATION				
Planning and organizing work	Planifier et organiser le travail	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Preparing audit programs	Rédiger des programmes de vérification	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Identifying significant factors	Déterminer les facteurs importants	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Gathering complete supporting evidence	Rassembler toutes les preuves à l'appui	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interviewing	Faire subir des entrevues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Preparing and maintaining working papers	Rédiger et tenir à jour des documents de travail	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Analysing material	Analyser la documentation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
REPORTING AND PRESENTATION	RAPPORTS ET PRÉSENTATION				
Preparing draft observations	Rédiger des ébauches d'observations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Preparing and presenting exit interviews	Préparer et tenir des entrevues de départ	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Preparing draft audit report	Rédiger des ébauches de rapport de vérification	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
PROFESSIONAL CONDUCT	ATTITUDE PROFESSIONNELLE				
Maintaining compatible relationships	Entretenir des relations compatibles	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Dependability	Fiabilité	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Maintaining confidentiality	Assurer le caractère confidentiel	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Meeting agreed deadlines	Satisfaire aux délais convenus	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Unsatisfactory: An individual does not meet one or more of the fundamental requirements of the position. Possible indicators of unsatisfactory performance are: quality of the work depicts serious shortcomings or the quality produced is below what is acceptable, and the results are inadequate; due dates are often missed; lack of understanding of job after review with supervisor; insufficient attempt or lack of ability to improve and little initiative in work and accomplishment; working relationships with others are poor to the point of being seriously detrimental to the work.

Satisfactory: Work performance, in the overall, is sufficient. The fundamental requirements of the position have been discharged in an adequate manner. Many of the expectations and results, as previously considered by the supervisor and the subordinate have been met. Examples might be that work has been generally completed on schedule but, in some instances, time frames have been exceeded; has on occasion required additional direction and overseeing, most policies and procedures have been understood but some objectives have not been realized. There is a recognizable requirement for additional training or refurbishing of skills and knowledge, especially in order for the performance level to become "Fully satisfactory".

Fully Satisfactory: Represents thorough competence and adeptness. The criteria and expectations which have been established by the supervisor with the subordinate have, without any significant exceptions, been met and may sometimes have been exceeded. Examples might be: always completes work on time and within budget; works within agreed upon responsibilities and objectives; policies and procedures are clearly understood and successfully applied; thoroughly comprehends and contributes to the role and mission of the work unit; copes with more important problems. In summary, this level of performance consistently meets all the requirements of the position.

Superior: Represents significant and tangible breakthrough in work over the course of the performance period beyond the competent level. This is designated when an employee's performance is generally beyond the requirements of the position and the criteria established. Examples might be: employee always completes work on time and within budget, and frequently ahead of both; performs work well independently, identifies solutions to most problems, responsibilities and objectives have often been surpassed; seeks additional responsibilities; successfully manages several activities or projects within the same time frame; identifies areas where practices or policies might be improved; demonstrates initiatives in work, etc. In summary performance results in this category clearly moves the work of the unit ahead.

Insatisfaisant: L'employé dont le rendement correspond à cette catégorie ne peut répondre à une ou plusieurs exigences fondamentales du poste. Voici quelques indices qui peuvent permettre de déceler un rendement insatisfaisant: de graves lacunes sur le plan de la qualité du travail ou une qualité de travail en deça des normes acceptables et des résultats inadéquats, des difficultés fréquentes à respecter les délais, une mauvaise compréhension du travail après examen avec le superviseur, des efforts insuffisants ou un manque d'amélioration, peu d'esprit d'initiative vis-à-vis du travail et de son exécution; de mauvaises relations de travail avec ses collègues qui mettent sérieusement son travail en péril.

Satisfaisant: Cette catégorie s'applique à un rendement au travail qui, dans l'ensemble, est suffisant. Le titulaire s'acquitte adéquatement des exigences fondamentales du poste. Il atteint plusieurs des objectifs et résultats qu'il a étudiés auparavant avec son supérieur. À titre d'exemples, le travail est généralement terminé à temps, mais il arrive parfois que les délais ne sont pas respectés, qu'à l'occasion, il est nécessaire d'assurer une orientation et une surveillance supplémentaires, que l'employé comprend bien la plupart des politiques et procédures, mais n'atteint pas certains objectifs. Il est évident que le titulaire a besoin de formation plus poussée et que ses aptitudes doivent être ravivées et ses connaissances rafraîchies, tout particulièrement pour lui permettre d'atteindre un niveau de rendement "entièrement satisfaisant".

Entièrement satisfaisant: Cette catégorie de rendement est retenue dans le cas d'un employé qui fait preuve d'une compétence à toute épreuve. Les critères et prévisions établis par le supérieur et l'employé sont respectés, sauf dans de rares occasions, et parfois ils sont même dépassés. Par exemple, l'employé termine habituellement son travail en respectant les délais et budgets prévus; il travaille en fonction des responsabilités et objectifs convenus, les politiques et procédures lui sont familières et il les applique avec succès, il comprend bien le rôle et la mission de l'unité de travail et contribue à les mener à bien, il réussit à venir à bout de difficultés plus importantes. Bref, l'employé de cette catégorie répond à la majorité, voire à toutes les exigences du poste.

Supérieur: Dans cette catégorie de rendement, on retrouve les employés qui ont accompli, de façon plus que convenable, pendant la période visée, des travaux importants et tangibles. Autrement dit, le rendement de l'employé se situe généralement au-dessus des exigences du poste et des critères établis. Ainsi, l'employé termine toujours son travail en respectant les délais et budgets prévus, et il arrive même qu'il puisse fournir le travail plus vite et à coût moindre, il peut s'acquitter seul de son travail de façon adéquate, il trouve des solutions à la majorité des problèmes, ceux qui lui ont été fixés, il cherche à obtenir plus de responsabilités, il parvient à administrer avec succès plusieurs activités ou projets dans un même délai; il peut cerner les secteurs nécessitant des améliorations sur le plan des pratiques ou des politiques; il fait preuve d'initiative, etc. En résumé, un rendement pouvant être qualifié de supérieur faisant, sans aucun doute possible, avancer l'unité de travail tout entière.

Comments

Note: Use separate sheet of paper if necessary

Supervisor's Comments

Date

Signature

Director's Comments

Date

Signature

Employee's Comments

I have read and understood this appraisal

Date

Signature

Director
Le Directeur

<u>THE FOLLOWING IS A BRIEF DESCRIPTION OF THE APPRAISAL CATEGORIES FOR THE GUIDANCE OF THE APPRAISER.</u>	<u>VOICI UNE BRÈVE DESCRIPTION DES CATÉGORIES D'APPRÉCIATION À L'INTENTION DE L'APPRÉCIATEUR</u>
<p>• <u>OUTSTANDING:</u> For employees about whose performance there are no reservations. They consistently <u>exceed</u> all the requirements and objectives of their positions to an exceptional degree.</p> <p><u>SUPERIOR:</u> For employees who substantially <u>exceed</u> most of the major requirements and <u>most</u> objectives of their position.</p> <p><u>FULLY SATISFACTORY:</u> For employees who fulfill all the general requirements and meet all the objectives of their positions in a completely satisfactory manner.</p> <p><u>SATISFACTORY:</u> For employees who fulfill most of the general requirements and meet most of the objectives of their positions.</p> <p><u>ACCEPTABLE:</u> For employees who do not fulfill all the requirements of their positions. They need further development and training.</p> <p>• <u>UNACCEPTABLE:</u> Performance does not meet minimum standards. Reassignment may be indicated.</p> <p>• Ratings given in these two categories require a written explanation.</p>	<p>• <u>REMARQUABLE:</u> Pour les employés dont le rendement n'est pas à discuter. Ils dépassent constamment tous les objectifs et satisfont à <u>toutes</u> les exigences de leur poste à un degré exceptionnel.</p> <p><u>SUPÉRIEUR:</u> Pour les employés qui dépassent substantiellement la plupart des principaux objectifs et font mieux que satisfaire aux exigences de leur poste.</p> <p><u>PLEINEMENT SATISFAISANT:</u> Pour les employés qui satisfont à toutes les exigences générales et atteignent <u>tous</u> les objectifs de leur poste d'une façon satisfaisante.</p> <p><u>SATISFAISANT:</u> Pour les employés qui satisfont à la plupart des exigences générales et atteignent <u>presque</u> tous les objectifs de leur poste.</p> <p><u>ACCEPTABLE:</u> Pour les employés qui ne satisfont pas à toutes les exigences de leur poste. Ils ont besoin de perfectionnement et de formation.</p> <p>• <u>INACCEPTABLE:</u> Le rendement ne répond pas aux normes minimales. Une nouvelle affectation peut s'imposer.</p> <p>• Les cotes attribuées à ces deux catégories exigent une explication écrite.</p>



Services Canada

Services Canada

PERSONNEL MANAGEMENT

GESTION DU PERSONNEL

Audit Services
BureauBureau des services
de vérificationCONFIDENTIAL
(when completed)CONFIDENTIEL
(une fois rempli)

I.A.40

ASSIGNMENT PERFORMANCE REVIEW REPORT
RAPPORT D'ÉVALUATION DU RENDEMENT DANS LE CADRE D'AFFECTATIONS

INSTRUCTIONS FOR USE: THIS REPORT IS TO BE BASED ON THE AUDITOR'S PERFORMANCE ON THE SPECIFIC ASSIGNMENT(S) NOTED BELOW. ALL SECTIONS ARE TO BE SUPPORTED BY NARRATIVE COMMENTS. THE REVIEW SHOULD BE DISCUSSED WITH THE AUDITOR.		MODE D'EMPLOI: CE RAPPORT DOIT FAIRE ÉTAT DU RENDEMENT DÉMONTRÉ PAR LE VÉRIFICATEUR AU COURS DE LA OU DES AFFECTATIONS INDIQUÉES PLUS BAS. VOUS DEVEZ FOURNIR DES COMMENTAIRES DÉTAILLÉS POUR CHAQUE SECTION ET LES DISCUTER AVEC L'INTÉRESSÉ.	
AUDITOR - VÉRIFICATEUR		DIVISION OR REGION - DIVISION OU RÉGION	
ASSIGNMENT(S) - AFFECTATION(S)		CLASSIFICATION	
ASSIGNMENT DURATION - DURÉE DE L'AFFECTATION		FILE NUMBER - NUMÉRO DE RÉFÉRENCE	
JOB KNOWLEDGE: DID THE AUDITOR DEMONSTRATE THE REQUIRED KNOWLEDGE OF AUDITING THEORY, METHODS, TECHNIQUES, INTERNAL CONTROL, ACCOUNTING, BUREAU MANUALS, COMPUTER AND STATISTICAL SKILLS, ETC.?		CONNAISSANCE DU TRAVAIL: LE VÉRIFICATEUR A-T-IL FOURNI LA PREUVE QU'IL POSSÉDAIT LES CONNAISSANCES REQUISES À L'ÉGARD DES PRINCIPES, DES MÉTHODES ET DES TECHNIQUES, DES SYSTÈMES DE CONTRÔLE INTERNE ET DE COMPTABILITÉ, DES GUIDES DU BUREAU, DE L'INFORMATIQUE, DES STATISTIQUES, ETC.?	
DID THE AUDITOR RECOGNIZE SIGNIFICANT AUDIT "FACTS" AND DIFFERENTIATE BETWEEN MATERIAL AND NON-MATERIAL ITEMS IN CONDUCTING THE AUDIT?		LE VÉRIFICATEUR A-T-IL ÉTÉ CAPABLE D'IDENTIFIER LES ÉLÉMENTS DE VÉRIFICATION APPROPRIÉS ET DE DIFFÉRENCIER, AU COURS DE SON TRAVAIL, LES POSTES PERTINENTS DE CEUX QUI NE L'ÉTAIENT PAS?	
DID THE AUDITOR OBTAIN SUFFICIENT COMPETENT AND RELEVANT EVIDENCE TO PROVIDE A REASONABLE BASIS FOR HIS OPINIONS, CONCLUSIONS, JUDGEMENTS AND RECOMMENDATIONS?		LE VÉRIFICATEUR A-T-IL RECUEILLI SUFFISAMMENT DE PREUVES SOLIDES ET APPROPRIÉES POUR ÉTAYER, DE FAÇON RAISONNABLE, SES OPINIONS, CONCLUSIONS, JUGEMENTS ET RECOMMANDATIONS?	
QUALITY OF WORK: WAS THE AUDITOR'S COMPLETED ASSIGNMENT SATISFACTORY IN TERMS OF ACCURACY, APPLICATION OF POLICY AND PRINCIPLES, PREPARATION OF REQUIREMENT DOCUMENTS, CONSISTENT AND IMPARTIAL TREATMENT OF CLIENTS, ETC.?		QUALITÉ DU TRAVAIL: LA TÂCHE DU VÉRIFICATEUR UNE FOIS TERMINÉE ÉTAIT-ELLE SATISFAISANTE EN TERMES DE PRÉCISION, D'APPLICATION DES POLITIQUES ET DES PRINCIPES, DE PRÉPARATION DES DOCUMENTS NÉCESSAIRES, DE RAPPORTS SUIVIS ET IMPARTIAUX AVEC LES CLIENTS?	
QUANTITY OF WORK: DID THE AUDITOR COMPLETE THE ASSIGNED TASKS IN AS THOROUGH A MANNER AS POSSIBLE UNDER THE TIME CONSTRAINTS (I.E. DID HE COVER ALL ANGLES AND PROVIDE ALL THE REQUIRED DOCUMENTS, ETC.)?		QUANTITÉ DE TRAVAIL: LE VÉRIFICATEUR A-T-IL ACHEVÉ COMPLÈTEMENT LES TÂCHES QUI LUI AVAIENT ÉTÉ CONFÉIÉES, COMPTE TENU DES CONTRAINTES DE TEMPS (PAR EXEMPLE, A-T-IL ÉTUDIÉ TOUTS LES ASPECTS DE LA TÂCHE ET FOURNI TOUTS LES DOCUMENTS NÉCESSAIRES, ETC.)?	
ABILITY TO: ANALYSE AND EVALUATE: DID THE AUDITOR USE GOOD JUDGEMENT IN THE CHOICE OF AND APPLICATION OF APPROPRIATE TESTS AND PROCEDURES?		APTITUDES À: ANALYSER ET ÉVALUER: LE VÉRIFICATEUR A-T-IL DÉMONTRÉ UN BON JUGEMENT DANS LE CHOIX ET L'APPLICATION DES CONTRÔLES ET DES MODALITÉS APPRouvÉES?	
DID THE AUDITOR DEMONSTRATE AN ALERTNESS TO SITUATIONS OR TRANSACTIONS THAT COULD INDICATE POSSIBLE FRAUD, IMPROPER OR ILLEGAL EXPENDITURES OR OPERATIONS, INEFFICIENCY, WASTE OR LACK OF EFFECTIVENESS?		LE VÉRIFICATEUR S'EST-IL MONTRÉ PERSPICACE ET HABILE À DÉCELER LES SITUATIONS OU LES TRANSACTIONS LOUCHES IMPLIQUANT PEUT-ÊTRE DES FRAUDES, DES DÉPENSES OU DES ACTIVITÉS INAPPROPRIÉES OU ILLÉGALES, DES PERTES DUES À UNE MAUVAISE EXPLOITATION OU À UN MANQUE D'EFFICACITÉ?	
DID THE AUDITOR CAREFULLY ANALYSE AUDIT FACTS AND MAKE THE BEST RECOMMENDATIONS POSSIBLE IN THE CIRCUMSTANCES?		LE VÉRIFICATEUR A-T-IL ANALYSÉ AVEC ASSEZ DE SOIN LES ÉLÉMENTS À VÉRIFIER ET, EN REGARD DES CIRCONSTANCES, A-T-IL PRÉSENTÉ LES MEILLEURES RECOMMANDATIONS POSSIBLES?	
PLAN: DID THE AUDITOR ENGAGE IN ACTIVITIES WHICH WERE NOT ESSENTIAL TO MEET THE OBJECTIVES OF THE ASSIGNMENT (I.E. THE PREPARATION OF UNNECESSARY WORKING PAPERS, ETC.)?		PLANIFIER: LE VÉRIFICATEUR S'EST-IL DISPERSÉ DANS DES ACTIVITÉS NON ESSENTIELLES À LA RÉALISATION DES OBJECTIFS DE SA TÂCHE (PAR EXEMPLE, LA RÉDACTION DE DOCUMENTS DE TRAVAIL INUTILES, ETC.)?	
DID THE AUDITOR DEVELOP A SYSTEMATIC PROGRAM OF ACTION TO ACHIEVE THE OBJECTIVES OF THE ASSIGNMENT (I.E. DID HE DEMONSTRATE AN UNDERSTANDING OF THE TOTAL OPERATION, INCLUDING OBJECTIVES, REQUIREMENTS AND PROBLEMS)?		LE VÉRIFICATEUR S'EST-IL ÉLABORÉ UN PROGRAMME SYSTÉMATIQUE D'ACTION POUR RÉALISER LES OBJECTIFS DE SA TÂCHE (PAR EXEMPLE, A-T-IL DÉMONTRÉ QU'IL COMPRENAIT BIEN LE CYCLE DE LA VÉRIFICATION, Y COMPRIS LES OBJECTIFS, LES EXIGENCES ET LES DIFFICULTÉS)?	

ORGANIZE:
DID THE AUDITOR PROVIDE AND STRUCTURE THE MATERIAL AND PERSONNEL
REQUIRED TO PERFORM THE ASSIGNED TASK?

ORGANISER:
LE VÉRIFICATEUR A-T-IL FAIT APPEL AU PERSONNEL ET OBTENU LE MATÉRIEL
NÉCESSAIRES À L'ACCOMPLISSEMENT DE SA TÂCHE?

I.A.41

DID THE AUDITOR EFFECTIVELY UTILIZE THESE WORK RESOURCES?

LE VÉRIFICATEUR A-T-IL UTILISÉ DE FAÇON EFFICACE LES RESSOURCES MISES À
SA DISPOSITION?

CONTROL:
DID THE AUDITOR MEET TIME TARGETS ON THE ASSIGNED TASK?

CONTRÔLER:
LE VÉRIFICATEUR A-T-IL RESPECTÉ LES ÉCHÉANCES FIXÉES?

DID THE AUDITOR ATTAIN AUDIT OBJECTIVES WITHIN A MINIMUM OF DIRECTION
AND GUIDANCE?

LE VÉRIFICATEUR A-T-IL RÉUSSI À ATTEINDRE LES OBJECTIFS DE LA VÉRIFICA-
TION EN N'AYANT QUE TRÈS PEU RECOURS AUX DIRECTIVES ET AUX CONSEILS
DE SES SUPÉRIEURS?

DID THE AUDITOR MAINTAIN SUFFICIENT INDEPENDENCE SO THAT HIS OPINIONS,
CONCLUSIONS, JUDGEMENTS AND RECOMMENDATIONS WERE IMPARTIAL?

LE VÉRIFICATEUR A-T-IL SU DEMEURER ASSEZ INDÉPENDANT POUR QUE SES
OPINIONS, CONCLUSIONS, JUGEMENTS ET RECOMMANDATIONS AIENT UN CARAC-
TÈRE D'IMPARTIALITÉ?

DID THE AUDITOR KEEP THE ASSIGNMENT ON SCHEDULE AND IN CONFORMITY TO
THE REGULATIONS, APPROVED PROCEDURES AND GUIDELINES EXPECTED?

LE VÉRIFICATEUR A-T-IL RESPECTÉ LES ÉCHÉANCES, RÈGLEMENTS, PROCÉDURES
ET DIRECTIVES APPROUVÉS?

DIRECT:
DID THE AUDITOR PROVIDE LEADERSHIP AND GUIDANCE TO STAFF AND/OR TO
PEERS IN A SPECIALIST OR ADVISORY ROLE (I.E. DID HE GAIN ACCEPTANCE OF
HIS ADVICE THROUGH THE DEVELOPMENT OF CONFIDENCE IN HIS SERVICES)?

DIRIGER:
LE VÉRIFICATEUR A-T-IL MANIFESTÉ DES APTITUDES À DIRIGER ET À CONSEILLER
LE PERSONNEL ET/OU SES COLLÈGUES LORSQU'ON LUI A CONFIE UN TRAVAIL
SPÉCIALISÉ OU QU'ON LUI A FAIT JOUER LE RÔLE DE CONSEILLER (A-T-IL RÉUSSI
À FAIRE ACCEPTER SES CONSEILS GRÂCE À LA CONFIANCE QU'IL A SU INSPIRER)?

COMMUNICATE:
WERE THE AUDITOR'S WORKING PAPERS COMPLETE, ACCURATE, CLEAR,
UNDERSTANDABLE, LEGIBLE AND NEAT?

COMMUNIQUER:
LES DOCUMENTS DE TRAVAIL DU VÉRIFICATEUR ÉTAIENT-ILS COMPLETS, PRÉCIS
CLAIRS, FACILES À COMPRENDRE, LISIBLES ET PROPRES?

DID THE AUDITOR SUBMIT A FINAL REPORT WHICH DID NOT REQUIRE MATERIAL
CHANGE IN FACT OR CONTENT?

LE VÉRIFICATEUR A-T-IL PRÉSENTÉ UN RAPPORT FINAL QU'ON N'A PAS EU
BESOIN, PAR LA SUITE, DE RETOUCHER QUANT AU FOND OU À LA FORME?

DID THE AUDITOR COMMUNICATE WELL BOTH ORALLY AND IN WRITTEN FORM IN
THE CONDUCT OF THE ASSIGNED TASK?

LE VÉRIFICATEUR A-T-IL RÉUSSI À S'EXPRIMER FACILEMENT, ORALEMENT ET
PAR ÉCRIT, AU COURS DE SA TÂCHE?

CREATE AND INNOVATE:
DID THE AUDITOR HAVE OCCASION TO DEVELOP AN IMPROVEMENT IN PRODUCTI-
VITY, TECHNIQUE OR PRACTICE BY MODIFYING PROCEDURES OR OTHERWISE
INNOVATING IN THE PERFORMANCE OF THE ASSIGNED TASK?

CRÉER ET INNOVER:
LE VÉRIFICATEUR A-T-IL EU L'OCCASION AU COURS DE SES AFFECTATIONS
D'AMÉLIORER SA PRODUCTIVITÉ, SES TECHNIQUES OU PRATIQUES DE TRAVAIL,
EN MODIFIANT LUI-MÊME SES MÉTHODES OU EN ÉLABORANT DE NOUVELLES
FAÇONS DE PROCÉDER?

POTENTIAL FOR EFFECTIVENESS:
DID THE AUDITOR MAINTAIN EFFECTIVE RELATIONS WITH FELLOW STAFF
MEMBERS AND AUDITOR STAFF?

POSSIBILITÉS DE RENDEMENT:
LE VÉRIFICATEUR A-T-IL ENTRETENU DES RELATIONS DE TRAVAIL UTILES AVEC
SES COLLÈGUES ET LE PERSONNEL DE VÉRIFICATION?

OVERALL ASSESSMENT OF ASSIGNMENT(S) - COMMENTS

APPRÉCIATION GÉNÉRALE DE LA OU DES AFFECTATIONS -
COMMENTAIRES

SIGNATURE OF AUDITOR
SIGNATURE DU VÉRIFICATEUR

SIGNATURE OF AUDITOR IN CHARGE
SIGNATURE DU VÉRIFICATEUR CHARGÉ DE L'AFFECTATION

SIGNATURE OF MANAGER
SIGNATURE DU DIRECTEUR

DATE

DATE

DATE

APPENDIX B

INTERNAL AUDIT MANUAL - TABLE OF CONTENTS

Volume I - General

Chapter 1 Introduction

- Purpose of Manual
- Use of the Manual

Chapter 2 Summary of the Internal Audit Standards (23 standards)

Chapter 3 Mandate

(Mandate/Policy/Departmental Directive or equivalent; introduced and/or signed by the head of the department/agency).

Chapter 4 Audit Ethics

(The IIA "Ethics" could be included here)

Chapter 5 Description of the Department/Agency

Chapter 5 Internal Audit Organization

- Organization chart
- Position descriptions
- Delegation document(s)
- Audit Committee
- Relations with other organizations
- Etc.

Chapter 7 Internal Audit Systems and Procedures

(a) Planning

- Environment Assessment (Including definition of the audit universe)
- Strategic and Long-Term planning
- Current-year planning
- Resource Planning
 - Budget
 - Human Resource planning
 - Other (travel, contract, supplies, etc.)
- MBO System (where used)

(b) Office Administration

- Resource acquisition
 - staffing
 - supplies
 - contracting
 - space
 - furniture
 - library
 - etc.
- Filing System
- Security
- Reference Library
- Copying Machine
- Word Processing
- Attendance (working hours, leave, etc.)
- Etc.

(c) Control Systems

- Project/Assignment control
- Time sheet system
- Commitment control
- Financial reporting
- Directorate Performance reporting on accomplishments
vs objectives effectiveness, efficiency, economy;
monthly/quarterly/annually
- MBO Reporting (where used)
- Performance Appraisal System (assignment and yearly)
- Etc.

Chapter 8 Training Material

- Orientation Training
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Chapter 1 The Audit Process

- Auditee Relations
- Assignment Planning
- Review
- Evaluation
- Verification
- Reporting
- Follow-up

Chapter 2 Assignment Administration

- Team organization
- Preparation for fieldwork
- Working Paper Files/Permanent Files
- Supervision

Chapter 3 Audit Theory & Techniques

(See Internal Audit Handbook, Volumes I & II)

Volume III - Audit Guide Programs

- a) Generic Guide for Development of Guides/Programs
- b) Generic Guidelines (Developed by IACIA Working Groups)
- c) Departmental Guides/programs (Unique to the department or agency)

RISK DETERMINATION FOR INTERNAL AUDIT PLANNING PURPOSES

Introduction

In Chapter Three the basis for determining frequency and order of audit was a set of ranking criteria abstracted from the Standards for Internal Audit (see Table 1).

In his 1978 Report, the Auditor General suggested that internal auditors consider "materiality, importance to management and degree of risk, or opportunity" as criteria for assessing potential audit units.

Internationally, organizations such as the Swedish National Audit Bureau, which has an extremely broad mandate including "effectiveness audit", attempts to consider each entity by subjectively evaluating those entities in the universe in terms of their relative desirability for audit. It is apparent that such criteria are difficult to reduce to monetary or quantitative terms.

In the private sector and some "production" oriented government agencies it has been possible to reduce the various goals of audit to a single monetary measure using either a value added approach or the application of quantitative techniques such as expected value analysis.

In the public sector, because of the diverse nature of entities subject to audit and the lack of rigorous choice criteria, the problem of what process to use in ranking audit units remains largely unresolved. A few attempts have been made to deal with this problem quantitatively. These range in sophistication and complexity from a prioritization model based on utility theory to simple scoring models which usually consist of identifying the more significant criteria, assigning each criterion in each entity a score, weighting these scores and then summing for an overall entity score. The score and weights in these models are seldom rigorously defined or validated, however, to the degree that they reflect an organizations preference criteria they have at least local value for a specific time period.

Table 1
Table of Significance Criteria

CRITERIA	DETERMINENTS
(a) size	usually determined by <ul style="list-style-type: none"> • revenue generated • expenditures made • assets controlled • person years
(b) risk	risk is a function of <ul style="list-style-type: none"> • the extent and reliability of the control system • the vulnerability to loss • the vulnerability to criticism through poor products and services • political sensitivity
(c) major changes	<ul style="list-style-type: none"> • major changes in systems or organization • the implementation of new systems • the establishment of new organizations • changes in key personnel
(d) previous internal audits	<ul style="list-style-type: none"> • dates • findings and recommendations • the extent of follow-up and corrective action by management <p>(The discovery of major deficiencies in one unit may necessitate audits of similar units.)</p>
(e) work of other auditors or consultants	<p>The reports and audit plans of</p> <ul style="list-style-type: none"> • the Auditor General • the Comptroller General • Treasury Board • other evaluation groups • consultants
(f) concerns and needs of senior management	<ul style="list-style-type: none"> • Have priorities been identified by senior management? • Has senior management made a specific request for an audit to be done?
(g) special considerations	provision for other criteria which may have an impact on the ranking process.

All these problems notwithstanding, the fact remains that audit units must be ranked in some order of priority. Whether they choose to do so on a completely subjective basis or through a more objective approach, departments will have to develop and adopt priority setting models appropriate to their environment by using some combination of the above-mentioned ranking criteria, appropriately weighted according to their importance, if they are to produce acceptable audit plans. The major strength of a prioritization model is that it makes explicit management's decision-making criteria. In the absence of a generally accepted and scientifically rigorous quantitative system, a simple judgmental model incorporating some or all of the criteria listed in Table 1 can be used to advantage. An attribute scoring system may be used as an added feature for ranking audit units sufficiently homogeneous to make this approach meaningful. In any case, a systematic priority setting process would serve to improve the degree of consistency in the selection and planning of audits.

In the interest of providing further input for consideration in deciding on the criteria to be used for development of manageable audit units and reporting units, determination of frequency of audit and for determining the order in which audit units should be scheduled a ranking methodology, based on risk assessment, is presented in the following sections.

Risk as a Decision Criterion

The Standards state that in identifying manageable audit units "The audit units should be established in such a way as to provide a basis for effectively planning, controlling and executing the audit work. An audit unit is a potential assignment of manageable size, but of such scope and nature that, if audited with due care, it will produce significant and meaningful information for management."

In deciding on which potential audit universe elements should be absorbed into the audit plan, and in what form, three related decisions need to be made. The first is which audit universe elements, or groups of elements, deserve audit attention, i.e. are entities that when reported on "...will produce significant and meaningful information for management". The second is a decision on how to package audit universe elements, or groups of elements, that have been identified as worthy of inclusion in

the audit plan into audit assignments that are manageable (Manageable audit units). The third decision is, in what order should the manageable audit units be audited and/or how frequently.

To make the decisions discussed above we have to first decide on the criteria to be used. The second decision depends heavily on the audit manager's (planner's) experience in audit assignment management and on the quality and quantity of audit resources available for deployment. In cases where the audit universe is being defined and given audit coverage for the first time it may be desirable to experiment with a variety of forms of manageable audit unit and/or to consult with other audit managers in the internal audit community.

The first and third decisions may be made on the basis of the same criteria, namely risk. The essence of control activity in general is risk avoidance. That is, either avoiding, or minimizing deviations in actual performance from desired (planned) performance. Since internal auditing is primarily a control activity, performed on behalf of management, its primary aim is also risk avoidance.

The next step then is to define risk in sufficiently complete and inclusive terms that identification of the potential risk associated with any audit universe element will be facilitated.

Before launching into a detailed discussion of risk, two caveats need to be stated. First, we continue to subscribe to the statement in the Standards that "There is no standard model for identifying audit units, nor is it practical to attempt to develop one for application on a government-wide basis, because of the varying nature of departmental operations". Therefore, what follows should be treated not as a standard model, but as one possible framework which may be helpful in making explicit and evaluating the basis and dimensions of what will inevitably be judgemental decisions. Second, although in what follows a more structured approach to making the planning decisions involved will be advocated, this does not imply the belief that those decisions can be converted into a routinized, dollarization process, as is advocated in some internal audit planning models¹. The reason that dollarization is not an adequate concept, at least for the public sector environment is that the purpose of

public sector organizations is not usually strictly economic. The mandate of most public sector organizations includes economic and/or social goals, although these are generally accomplished through the use of public funds (i.e. economic means).

The process leading to decisions on which audit universe elements deserve attention within the next planning cycle, and in what order they should receive this attention, consists of two basic steps. These are the identification of risk potential and arriving at a consensus (between audit managers and with senior management).

Identification of risk potential

In identifying risk potential there are several ways in which the term risk can be characterized and broken down (disaggregated) into its components which could aid in the identification of the source of the risk, its nature and its materiality/significance.^{1, 2, 3, 4}

Those approaches reviewed all have shortcomings, either in terms of completeness or because they are not mutually exclusive, or both. Completeness is necessary so that all situations having risk potential are capable of being identified; in order to prevent double counting mutual exclusivity is mandatory in the aggregation of risk indicators.

In what follows an attempt is made to build upon those approaches provided in internal audit literature, while avoiding their weaknesses.

-
1. Quantitative Measurement of the Audit Universe and the Related Audit Effort - An Operating System; A research project of the International Research Committee, The Institute of Internal Auditors, Inc.
 2. A Framework For Evaluating Internal Audit Risk; IIA, Inc.
 3. Audit Project Evaluation Methodology; O. Ronald Gray; IIA Journal, June/83.
 4. Planning For the Internal Audit Function; J. Efrim Boritz, The Institute of Internal Auditors Research Foundation.

To start with, it is proposed that any index or indicator of risk, regardless of the level of disaggregation, be a function of two parameters; amount/significance, and probability/likelihood of occurrence. (From now on these will be referred to as significance and probability.) These two parameters may be combined to give a risk indicator in terms of "expected risk". Sources of information which could help in deciding on what subjective probability to assign each risk component chosen, are shown in Table 2.

A model showing possible levels of disaggregation of the significance parameter associated with the term risk, into its components, is shown in Figure 1. For each relevant component, at any chosen level, the values of the two parameters (significance, probability) would be assigned and then divided by the maximum possible score (i.e. normalized). The normalization is necessary in order that the indicators be capable of being compared for ranking purposes, regardless of the number of components chosen to represent the risk potential of the given audit unit.

Some illustrative examples, employing the proposed model at different levels of sophistication may help to demonstrate its use.

In the simplest case, the audit universe elements are grouped into manageable audit units using judgement, based on past audit experience. Then they are intuitively ranked as to importance to management by using a combination of one or more of the list of risk criteria shown on the left hand side of Table 3. This list is then used to determine the frequency of audit of the manageable audit units and the order in which they will be audited in any one year.

This approach has already been demonstrated by an example in Chapter Three.

Table 2

Sources of Risk Information

1. Managerial concerns
2. Past history
3. Previous audits
4. MIS/variance reports
5. Other, performance oriented reports
6. Environmental data indicating risk probability

Although this approach can be used successfully in relatively small departments and agencies it becomes progressively more arbitrary and suspect as the portfolio of audit universe elements grows. Also, this approach tends to delay the introduction of management concerns until the ranking phase of the planning process whereas it is preferable to introduce these concerns at an earlier stage, when audit universe elements are being combined into manageable audit units and reporting units.

Some large departments have attempted to introduce management concerns earlier, and to assign scales to the individual risk components and aggregate the results. They use weighting factors, to make the risk identification process more explicit and to avoid the arbitrariness and other potential weaknesses of the previously described approach. This approach could be an improvement if care is used to prevent double counting of factors which are not mutually exclusive, weighting factors are carefully chosen and validated, and the same risk components are used for each manageable audit unit. These are severe constraints, seldom adhered to.

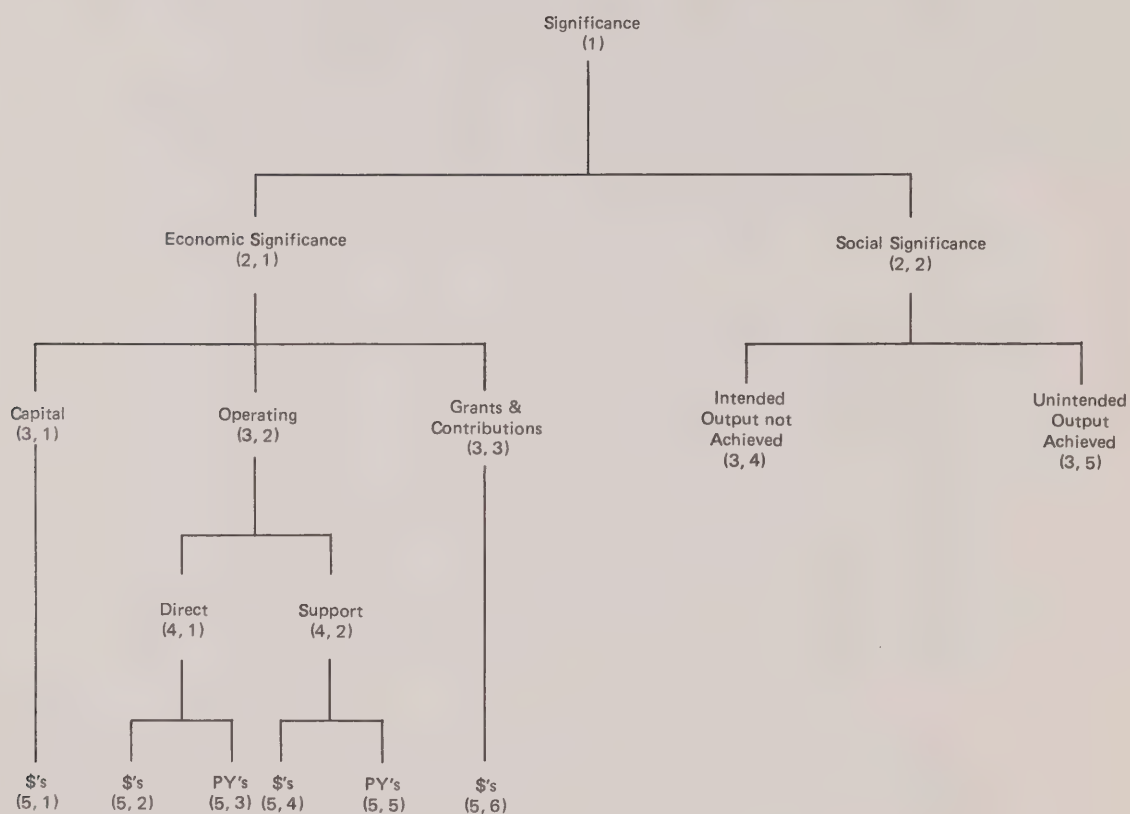
An approach which attempts to avoid the pitfalls of other methods is based upon the following model:

1. A "Significance Components" model (Figure 1) which allows for identification of risk in terms of "significance" at five levels of disaggregation. The level chosen by the planner will depend on the planner's approach to planning (structured, unstructured) and on the complexity of the organization being planned for. This model is reconciled with the ranking criteria provided in the Standards in Table 3. Each potential risk component consists of two parameters; significance (from Figure 1) and probability. Potential risk in this case is represented by the mathematical term, "expected risk", which is the product of significance and probability of occurrence.
2. It is proposed that scales be provided for the significance parameter of each risk component used, and that the numerical values assigned be normalized for each audit unit to facilitate ranking. This results in a significance index. (See Table 4 for an example of risk scales and Table 5 for an example of a normalization procedure.) The significance scales may be of two types, one based on quantitative data (illustrated in the following pages) and the other based on conviction (e.g. a scale of 1 to 5 with "1" indicating very low level of risk and "5" indicating a very high level of risk).
3. Once the significance indices have been assigned, the next step is to assign probabilities to each risk component. (See Table 6 for sources of relevant information.)
4. Finally the combined Potential Risk factors ($\text{Expected risk} = \text{Significance} \times \text{Probability}$) are normalized for each audit unit. This results in a Potential Risk Index. (See Table 7 for an illustration.) The proposed use of the significance and potential risk indices is as follows:
 - a) Utilize significance indices for determining manageable audit units/reporting units that are significant to management, and for

determining frequency of audit. (Refer to Chapter Three for elaboration of these two processes); and

- b) Utilize the potential risk indices for determining the order in which audit units should be audited.

SIGNIFICANCE COMPONENTS
(Five levels of disaggregation)



Note: Expected Risk = SXP where:
S = Significance
P = Probability

Figure 1

Table 3

Reconciliation with Ranking Criteria shown in the Standards and the structure as displayed in Figure 1.

<u>Ranking Criteria (Standards)</u>	<u>Risk Component</u>
1. <u>Size</u>	- Level 5; \$, PY's
2. <u>Risk of Loss</u>	- Risk Component (<u>Significance</u> , <u>Probability</u>) (All levels)
3. <u>Special Considerations</u>	- Level 4; a) Intended Output Not Achieved b) Unintended Output Achieved
4. <u>Major Changes</u>	- Risk Component (<u>Significance</u> , <u>Probability</u>) (All levels)
5. <u>Previous Internal Audits</u>	- All Components
6. <u>Work performed by other Auditors</u>	- All Components
7. <u>Known Desires of Management</u>	- All Components

Note: 5, 6, 7 are sources of criteria rather than criteria in themselves
(see Table 2 for other sources).

Table 4

Scales for Potential Risk Components

<u>Scale</u>	<u>Potential Risk Component</u>	<u>Actual Parameter Values</u>	<u>Assigned Scale Values</u>	<u>(1-5)</u>
1	(5,1), (5,2), (5,4) & (5,6)	below \$100,000	1	
		\$100,000 - \$299,000	2	
		\$300,000 - \$499,000	3	
		\$500,000 - \$999,000	4	
		\$1,000,000 and above	5	
2	(5,3) (5,5)	Less than 3	1	
		3 - 5	2	
		6 - 9	3	
		10 - 19	4	
		over 20	5	
3	(3,4), (3,5)	Significance:		
		Low	1	
			2	
		Medium	3	
			4	
		High	5	

Table 5

Normalization Procedure

<u>Managable Audit Unit</u>	<u>Risk Components</u>	<u>Significance</u>	<u>Normalized Value</u>
	(Level, Component) ¹	(Scale 1-5)	
1	(5,1)	4	
	(5,2)	2	
	Aggregate:	<u>6/10</u>	
	Normalized:		0.60
2	(4,3)	2	
	Aggregate:	<u>2/5</u>	
	Normalized:		0.40
3	3,2	5	
	3,3	3	
	4,4	2	
	Aggregate:	<u>10/15</u>	
	Normalized:		0.67

Significance Ranking Table of MAU's

<u>MAU</u>	<u>Significance Index²</u>	<u>Rank</u>
3	0.67	1
1	0.60	2
2	0.40	3

Notes

1 From Table 1

2 Ties may be broken in three ways:

1. Judgemental pair comparison
2. Adding risk factors for the tied units
3. Refining assignment of parameter values

Table 6

Sources of Information for Probability Determination

1. Managers (Interviews)
2. Management Information System reports
3. Operating Information System reports (e.g. Quality Assurance, Inspection)
4. Management Services'/consultant's reports
5. Internal Audit reports
6. Internal Audit Permanent Files
7. External Audit reports
8. Central Agency review reports
9. Program Evaluation reports
10. Reports on environmental problems/threats

Table 7

Normalization Procedure

<u>Managable Audit Unit</u>	<u>Risk Components</u>	<u>Significance</u>	<u>Probability</u>	<u>Expected Risk</u>	<u>Normalized Value</u>
	(Level, Component) ¹	(Scale 1-5)			
1	(5.1)	4	.5	2	
	(5.2)	2	.5	1	
	Aggregate:			<u>3/10</u>	
	Normalized:		3 ÷ 10 =		0.30
2	(4,3)	2	.7	1.4	
	Aggregate:			<u>1.6/5</u>	
	Normalized:		1.4 ÷ 5 =		0.28
3	3,2	5	1.0	5	
	3,3	3	0.7	2.1	
	4,4	2	0.8	1.6	
	Aggregate:			<u>8.7/15</u>	
	Normalized:		8.7 ÷ 15 =		0.58

Potential Risk Ranking Table of MAU's

<u>MAU</u>	<u>Potential Risk Index²</u>	<u>Rank (Order)</u>
3	0.58	1
1	0.30	2
2	0.28	3

Notes

1 From Table 1

2 Ties may be broken in three ways:

1. Judgemental pair comparison
2. Adding risk factors for the tied units
3. Refining assignment of parameter values

An illustrative example should help to explain how the proposed model would work. Suppose that the potential manageable audit unit under review, for inclusion in our plan, is the Budgets Division of the Financial Administration Branch (MAU No. 4), with a budget of \$600,000 and 9 person-years (Table 8). Suppose further that it has been decided that the significance parameter scale is: between 1 and 5 depending on whether the budget of the potential manageable audit unit is below \$100,000, between \$100,000 and \$299,000, between \$300,000 and \$499,000, between \$500,000 and \$999,000 and \$1,000,000 and above; between 1 and 5, depending on whether the person-years count is less than 3, between 3 and 5, between 6 and 9, between 10 and 19 and 20 or above; and, between 1 and 5, depending on whether the unit is considered a potentially low, intermediate or high risk area. (See Table 4 for a summary of these scales.)

If we now enter the risk disaggregation tree, on Figure 1 at level 5 we have two components under support (4,2), namely budget \$'s (5,4) and PY's (5,5) which are relevant. Using our scales for budgets and PY's (Table 3) we can assign values to the significance parameter as follows: 4 for budget and 3 for PY's (see Table 8 for a summary). This gives a normalized significance value (index) of .70. If we now assume a probability of occurrence of 0.70 for each risk component we obtain a normalized potential risk value for MAU No. 4 of $(2.8 + 2.1) \div 10 = 0.49$. Taking this normalized value and comparing it to MAU's no. 1, 2 and 3 in Table 7 it is readily seen that MAU No. 4 would rank 2nd after MAU 3 and ahead of MAU's no. 1 and 2.

Referring to Chapter Three, it is evident that the significance parameter (with suitable thresholds) may be used as a criteria for determining reporting units and frequency since it is equivalent to the risk/significance index used there. On the other hand, the normalized, expected potential risk parameter is more appropriate for determining the order in which audit units should be scheduled.

Arriving at a Consensus

Arriving at a consensus is a form of validation of the decisions made as to the risk potential of the various manageable audit units considered, and of the underlying assumptions.

Table 8

Potential Risk Summary Table

<u>MAU</u>	<u>Risk Component</u>	<u>Actual Parameter Value</u>	<u>Parameter Scale Value</u>	<u>Probability</u>	<u>Expected Risk</u>	<u>Normalized Value</u>
No. 4; (Budget Div., Financial Administration Branch)	5,4	\$ 600,000	4	.7	2.8	
	5,5	9	3	.7	2.1	
	Aggregate		<u>7/10</u>		<u>4.9/10</u>	
	Normalized		$7 \div 10 = 0.70$		$4.9 \div 10 = 0.49$	

Note

- * It would of course be easier, in this case, to simply multiply the budget (\$600,000) times the probability (.7) to get an expected risk of \$420,000, however, this approach would not provide a means of comparing or combining risk component 5,4 with other non-dollar, risk components (e.g. risk component 5,5).

Since audit plans should reflect management's concerns, consensus should be sought not only among auditors but with management as well, particularly senior management.

The consensus gathering process has inherent advantages, in that it facilitates better understanding and commitment on the part of both auditor and senior management to the audit plan.

It also has disadvantages. It is a time-consuming process which must be continually tested for the possibility that the point of diminishing returns has been reached. It may also create more ill will than understanding and commitment, if carried too far.

The process itself may be described in terms of the matrix shown in Figure 2. Four conditions that may arise during the process are shown, namely conditions 1, 2, 3 and 4.

Conditions 1 and 2 are straightforward, as in these cases there is agreement as to risk potential. Conditions 3 and 4 reflect two possible levels of disagreement. Condition 3 reflects agreement on facts but disagreement on criteria, or reconciliation of criteria and facts. This disagreement is crucial to the rest of the process because it is systemic, however, once resolved it clears the way for resolution of many disagreements through one negotiation effort, i.e. this type of disagreement has leverage on the whole consensus process and, therefore, is worth concentrating effort on doing well. It may involve reconsideration of risk components, per Figure 1, criteria, per Table 3, or simply subjective probability of occurrence.

The 4th condition could be a disagreement on facts, or criteria or both. The first step in resolution of this type of disagreement is determination of whether criteria or facts are the source. If criteria then it becomes a condition 3 problem and is handled within that framework (per the previous paragraph). If it is simply a question of insufficient data then the remedy is some form of preliminary survey. In the worst case it may mean that a partial audit is scheduled up to and including the review phase before a decision is made as to the risk potential of the particular manageable audit unit that is the focus of the disagreement.

The Consensus Gathering Process Matrice

Facts Required for Reaching Consensus	Agreement On Risk Potential	
	Parties Agree	Parties Don't Agree
Sufficient	1	3
Insufficient	2	4

Figure 2

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SUMMARY OF STANDARDS

CHAPTER ONE - ROLE OF INTERNAL AUDIT

1. Departments shall have an independent internal audit function that carries out a systematic review and appraisal of all departmental operations for purposes of advising management as to the efficiency, economy and effectiveness of internal management policies, practices and controls.

CHAPTER TWO - SCOPE AND FREQUENCY

2. Scope

The scope of internal audit shall encompass all aspects of a department's operations. The internal auditor assesses and expresses an opinion upon:

- a) The design, development, implementation, and operation of all systems, procedures, processes and controls, including computer-based systems;
- b) The reliability and adequacy of information available for decision-making and for accountability purposes;
- c) The extent to which available information is utilized in the decision-making process;
- d) The adequacy of protection afforded public funds and assets; and
- e) The extent of compliance with legislative, central agency and departmental directions.

3. Frequency

All major systems, functions and organizational units performing significant responsibilities should be examined within a period not exceeding three to five years.

CHAPTER THREE - ORGANIZATION AND RELATIONSHIPS

4. Reporting Relationship

The head of the internal audit group should report to the deputy head.

5. Audit Committee

There should be an audit committee chaired by the deputy head, composed of executives whose attributes assure the provision of sound and objective counsel to the deputy head.

6. Integration of Audit Activities

All internal audit activities shall be integrated to eliminate overlapping and duplication of work, and to contribute to the efficiency of internal auditing within the department.

7. Audit Agents

Where audit agents are used, there should be a written agreement with each agent that specifies audit objectives, audit scope, reporting relationships, the authority of the auditors, and the rights of the department to examine audit documentation.

CHAPTER FOUR - AUDIT INDEPENDENCE

8. Audit Policy

The deputy head shall approve and promulgate an audit policy which specifies the responsibility and authority of the audit group, outlines the scope and frequency of audit, and authorizes access to all departmental information necessary for the fulfilment of its mandate.

The policy should specify the responsibilities of auditees and the internal audit committee vis-à-vis the audit process.

9. Objectivity

Members of the internal audit group should execute each aspect of assigned audit work in a manner which is, and is perceived to be, objective.

CHAPTER FIVE - AUDIT STAFF

10. Size and Skills

The internal audit group should be of sufficient size and possess the skills necessary to carry out its mandate.

11. Professional Development

The internal audit group and the individual auditor should have a common obligation to develop and maintain professional skills through training courses, on-the-job training, personal self-improvement, and a formal program of annual appraisals.

CHAPTER SIX - PLANNING AND SCHEDULING

12. Long-term Plan

A long-term plan of the activities of the audit group shall be prepared and documented to ensure that the organization's audit policy is met efficiently and effectively.

13. Annual Schedule

An annual schedule of planned audit assignments shall be prepared and submitted to the deputy head for approval.

CHAPTER SEVEN - PERFORMING THE AUDIT

14. Assignment Planning

Every audit assignment should be properly planned.

15. Performance

There should be a sufficient study and evaluation of the operational and management systems, procedures, processes and controls as a basis for conducting the detailed review and tests required to identify and disclose weaknesses and inefficiencies.

16. Due Care

Each auditor should exercise due care in the performance of the audit.

17. Evidence

Sufficient valid and relevant evidence should be obtained and documented to support the content of audit reports.

18. Supervision

Staff engaged in all phases of an audit assignment should be subject to adequate supervision.

19. Supervisory Review

All audit work should be subject to a properly planned and documented review process conducted by the appropriate level of qualified supervisory staff.

CHAPTER EIGHT - REPORTING

20. Assignment Report

A written report shall be issued to appropriate officials of the department or agency at the conclusion of every audit assignment.

The report must be timely, accurate, clearly stated, complete yet concise and recommend corrective action when appropriate.

21. A report shall be submitted to the deputy head at least annually on audit coverage, major findings, significant unresolved recommendations and any other matters requiring the deputy head's attention.

22. Post-Audit Consultation

Audit findings and recommendations should be discussed with relevant officials prior to issuing the report and their comments included in the report, as appropriate.

23. Follow-up

The internal audit group should assess whether appropriate follow-up action has been taken on the implementation of audit recommendations and it should report inadequate action.

INTERNAL AUDIT CODE OF ETHICS

(Abstracted from The Institute of Internal Auditors' Code of Ethics and annotated to suit the federal government environment.)

INTERPRETATION OF PRINCIPLES

The provisions of this Code of Ethics cover general basic principles which apply to all internal audit in the practice regardless of the disciplines involved. A member shall realize that individual judgement is required to the application of these principles. He/she has a responsibility to conduct himself so that his/her good faith and integrity should not be open to question. While having due regard for the limit of his technical skills, he/she will promote the highest possible internal auditing standards to the end of advancing the interest of his/her company or organization.

ARTICLES

- I. An Internal Auditor shall have an obligation to exercise honesty, objectivity and diligence in the performance of his or her duties and responsibilities.
- II. An internal auditor, in holding the trust of his/her employer, shall exhibit loyalty in all matters pertaining to the affairs of the employer or to whomever he or she may be rendering a service. However, a member shall not knowingly be a party to any illegal or improper activity.
- III. An internal auditor shall refrain from entering into any activity which may be in conflict with the interest of his or her employer or which would prejudice his or her ability to carry out objectively his or her duties and responsibilities.
- IV. An internal auditor shall not accept a fee or a gift from an employee, a client, a customer or a business associate of his or her employer without the knowledge and consent of his or her senior management.

- V. An internal auditor shall be prudent in the use of information acquired in the course of his or her duties. He or she shall not use confidential information for any personal gain or in a manner which would be detrimental to the welfare of his or her employer.
- VI. An internal auditor, in expressing an opinion, shall use all reasonable care to obtain sufficient factual evidence to warrant such expression. In reporting, an internal auditor shall reveal such material facts known to him or her which, if not revealed, could either distort the report of the results of operations under review or conceal unlawful practice.
- VII. An internal auditor shall continually strive for improvement in the proficiency and effectiveness of his or her service.
- VIII. A federal government internal auditor shall abide by the Standards for Internal Audit in the Government of Canada. In the practice of his or her profession, he or she shall be ever mindful of his or her obligation to maintain a high standard of competence, morality and dignity.



No. 1983-01
Date: 01-09-83

Internal Audit
Policy Interpretation Notice

Subject: INTRODUCTION TO THE ISSUANCE
OF POLICY INTERPRETATION NOTICES

Office of the Comptroller General

Policy Development Branch
Internal Audit and Special
Studies Division

PURPOSE AND SCOPE

The purpose of this Policy Interpretation Notice (PIN) is to provide to the internal audit community a general description of what can be expected from future PINs, the rationale behind this new procedure and the action requested from internal audit groups in response to the suggestions provided.

ISSUES

The Standards for Internal Audit in the Government of Canada, issued in 1982 by the OCG, identify in concise form the broad concepts vital to an effective internal audit function. As these concepts have been interpreted and applied by various internal audit groups within the government, the need for supplementary explanation or guidance has been expressed to the Internal Audit and Special Studies Division (IASSD) through its ongoing liaison and performance assurance review activities. In addition, new initiatives within the government and the profession have created other needs for guidance.

In response to these identified needs, IASSD will adopt, as part of its overall activities, a procedure of issuing PINs which will provide the supplementary guidance required for various internal audit practices.

Questions concerning this notice should be directed to:

INTERNAL AUDIT AND SPECIAL STUDIES DIVISION
POLICY DEVELOPMENT BRANCH
OFFICE OF THE COMPTROLLER GENERAL
(613) 996-6171 or 995-1297

INTERPRETATION NOTICE POSITION

Most PINs will be created to aid consistency in internal audit procedures, provide technical advice, share common information or suggest the creation of new general procedures.

Each notice will consist of the following standard headings:

- purpose and scope: indicating the content of the notice;
- issues: specifying the main reasons that prompted the development of the notice;
- interpretation notice position: providing a précis of position papers, discussion papers or supporting material relevant to the guidance in question; where the guidance can be briefly stated, it will be provided in its entirety in this section;
- disposition: indicating the action requested from internal audit groups, the monitoring activities of IASSD and an indication of whether the interpretation notice position will be ultimately incorporated within more formal policy and procedural documents such as the Standards for Internal Audit or the IACIA Internal Audit Handbook;
- references (optional): identifying the legislative and official documentary references that are the basis of the interpretation notice position;
- information and assistance (optional): providing the names and telephone numbers of personnel who can provide information concerning specific applications of suggestions included in the notice where this would be useful.

The positions presented in the notices will be suggested positions, and therefore compliance will not be mandatory. The notices are meant to provide supplementary information which may be helpful to the internal audit community when interpreting and applying the concepts of the Standards to their unique departmental environment.

DISPOSITION

Questions, commentary and suggestions relating to the use of future PINs and areas where supplementary guidance would be helpful are requested from the internal audit community. Information, in this regard, can be provided through contacting the IASSDs liaison officers at (613) 996-6171 or (613) 995-1297.



No. 1983-02
Date: 01-09-83

Internal Audit
Policy Interpretation Notice

Subject: AUDIT WORKING PAPERS

Office of the Comptroller General

Policy Development Branch
Internal Audit and Special
Studies Division

PURPOSE AND SCOPE

The purpose of this notice is to announce the issuance of a position paper (refer to attachment) by the Internal Audit and Special Studies Division (IASSD) relating to the purposes, principles, content, structure, retention and disposal practices associated with good audit working papers.

The position paper has been prepared primarily to ensure that the traditional purposes of audit documentation are achieved in the federal government through a uniform and disciplined approach to audit working paper practices. A secondary reason for this guidance is to facilitate compliance with the requirements of the Access to Information Act and the revised TBS Records Management Policy where these initiatives impact audit working papers.

ISSUES

In the conduct of performance assurance review and liaison activities, practices relating to the preparation of internal audit working papers were found to vary among internal audit groups. In certain instances, the traditional purposes associated with audit documentation were not fully served by the existing working papers.

The Standards for Internal Audit in the Government of Canada refers to the types of information an auditor would normally consider during the course of an assignment, but specific guidance relating to working paper preparation and retention was beyond the scope of that document. Consequently the attached position paper, "Audit Working Papers", provides supplementary guidance to enhance the overall quality of audit documentation.

6&5

working together
travaillons ensemble

Canada

Questions concerning this notice should be directed to:

INTERNAL AUDIT AND SPECIAL STUDIES DIVISION
POLICY DEVELOPMENT BRANCH
OFFICE OF THE COMPTROLLER GENERAL
(613) 996-6171 or 995-1297

Canada

With the right of public access to certain aspects of working papers formalized in the new Access to Information Act, the need for auditors to exercise care in the preparation of working papers is heightened. Audit documentation should be organized to allow disclosure to be handled economically, efficiently and effectively. In addition, the auditor must make certain that information retained in working papers is relevant, understandable, accurate and complete such that all reviewers are properly informed of matters pertaining to the audit.

INTERPRETATION NOTICE POSITION

The first two sections of the position paper clarify the purposes associated with audit documentation and the principles of proper working paper preparation. These sections serve as the basis for the approach taken in subsequent sections of the paper relating to content, organization and retention of audit documentation.

The next section of the paper describes the necessary documentation that should result from each stage of the audit process and indicates the primary purposes served by individual working paper documents. Standard designs for working papers are not prescribed, rather, emphasis is placed upon how working papers support the activities of the auditor in each of the major stages of the assignment.

General principles relating to the organization of working papers are then identified. Methods of indexing and cross-referencing are illustrated as are the uses of various working paper headings.

The final section of the position paper highlights the current retention and disposal requirements related to audit working papers. It indicates that the existing six-year retention period for audit documentation will be studied for adequacy by IASSD.

Throughout the paper, reference is made to the implications of the Access to Information Act on audit working paper practices. In summary, the following points should be considered:

- although audit documentation has always served the important purpose of facilitating third-party review, this purpose will assume greater significance given the right of public access to working papers;
- with the extension of the readership of audit documentation that may occur under the Act, a review of the emphasis placed upon the principles of working paper preparation may be in order;
- specification of the normal contents of working papers will provide a basis for determining the nature and extent of information the public can reasonably expect for typical audits;

- in the organization of working papers, auditor's should consider ways of allowing efficient segregation of exempt or excluded information from the main body of working papers which may be released; and
- proper retention of working papers takes on obvious significance given the general public's legal right of access to government records.

DISPOSITION

The internal audit community is requested to provide comment to IASSD on the position paper. It is suggested that internal audit groups compare their existing working paper practices to the practices recommended in the position paper and report to IASSD instances where they feel the suggestions provided will not achieve the desired effects.

Ultimately, the final position on audit working papers will be incorporated within the IACIA Internal Audit Handbook. Monitoring of working paper practices in departments will be performed as a part of the performance assurance review program of IASSD and will be based primarily on the guidance provided in this PIN.

AUDIT WORKING PAPERS

**A POSITION PAPER
IN SUPPORT OF PIN 1983-02**

Internal Audit and Special
Studies Division
Policy Development Branch

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Appendices

Appendix A	Illustration of background planning information and the contents of an assignment planning memorandum
Appendix B	Illustration of summary working papers
Appendix C	Illustration of indexing/cross-referencing system for working papers

CHAPTER ONE

INTRODUCTION

For several years the internal audit community has recognized that the preparation of good audit working papers is an essential part of audit work. Though few auditors would disagree with the importance of audit documentation, practices governing the content, organization, use, retention and disposal of working papers in the federal government vary widely.

The publication, Standards for Internal Audit in the Government of Canada as promulgated by the OCG, refers to the types of information an auditor would normally consider during the conduct of an assignment, but it was not intended as guidance to ensure a consistent approach to audit working paper preparation. This paper bridges the gap between the Standards and the various practices relating to audit working papers that have been adopted within departments.

The primary reason for the provision of guidance in this paper is to help ensure that the traditional purposes of audit documentation are achieved through a uniform and disciplined approach to audit working paper content, structure and retention practices. A secondary reason for this guidance is to facilitate compliance with the requirements of the Access to Information Act and the TBS records management policy where it impacts on the audit working papers.

The introduction of the Access to Information Act and a revised records management policy heighten the need for auditors to exercise care in the preparation of working papers. With the right of public access to certain aspects of working papers formalized in law, auditors are required to ensure that audit documentation is organized in a manner which will allow disclosure to be handled economically, efficiently and effectively. In addition, the auditor must make certain that information retained in working papers is relevant, understandable, accurate and complete so that all reviewers are properly informed of matters pertaining to the audit.

Scope of the Position Paper

The following major topics will be dealt with in this position paper:

- the purposes of internal audit working papers;
- general principles relating to the preparation of audit working papers;
- appropriate audit working paper content;
- organization and structure of working papers; and
- working paper retention practices.

In this paper, the term working papers refers to the formal records of the plans the auditors made, the procedures they performed, the audit evidence they obtained and the conclusions they drew in arriving at their final report. There are normally two types of working paper file maintained for each audited entity - a permanent file used over many years and current working paper files prepared to support the auditor's most recent assessment of the audit entity under review. The chapters of this paper relating to purposes, principles and content are associated with all audit documentation accumulated during an assignment, and are not concerned as to whether the information is current or permanent in nature. The section on organization and structure of working papers provides a method whereby the necessary content of assignment documentation can be logically arranged between current and permanent files.

The guidance provided here is directed towards all audit documentation prepared within the internal audit community of the federal government, whether it be prepared by the internal audit group, or by agents hired through the contracting process.

CHAPTER TWO

THE PURPOSES OF AUDIT WORKING PAPERS

The purposes of working papers described below, will serve as a basis for the approach taken in subsequent sections of this paper relating to the content, organization and retention of working papers. All audit documentation should be accumulated or prepared with these purposes in mind, so as to give maximum benefit to the auditors and interested third parties.

The most important purposes of audit working papers are:

- to facilitate effective conduct and management of the audit assignment;
- to provide support for the auditor's report; and
- to provide background and control for follow-up actions taken to correct deficiencies.

Other derived purposes are:

- to facilitate third-party review;
- to aid professional development; and
- to provide a source of information for non-audit purposes.

Facilitating Effective Conduct and Management of the Audit Assignment

Good working papers can contribute to the effectiveness of various administrative tasks required for the proper management of an audit assignment.

This section will outline these administrative tasks and the related contribution working papers can make towards allowing the tasks to be discharged effectively.

a) Facilitating adequate planning (including the assignment of necessary resources)

Documentation within the working papers of the planning decisions relating to audits in process, helps to ensure that:

- planning is completed in an organized manner;
- planning decisions are followed during the conduct of the field work (or explanations provided where changes occur); and
- an appropriate reference point is available for review both during and upon completion of the audit.

Audit projects are often repeated, extended to cover additional areas or used as a basis for planning other assignments. Given the typical limitations on staff continuity, good working papers contribute to the quality of subsequent or complementary audits by providing a good starting point for succeeding auditors to:

- reduce time spent in understanding the nature of the auditee's operations;
- identify areas of audit risk;
- determine the scope of audit coverage; and
- determine, with a greater degree of accuracy, the time and staff required.

b) Facilitating an organized approach

A standardized structure for working papers helps to provide a useful framework for the organization of the audit work. Uniformity in structure enables several staff members or separate offices to work on different segments of a single assignment in a co-ordinated manner.

An organized file influences the manner by which complex systems are reviewed, helping to ensure that major areas are not overlooked and that adequate depth of coverage is provided.

c) Facilitating adequate control of field work

A uniform file structure and method of preparing working papers provide guidance to audit staff on the job, reduce the chance of omission or of incorrect application of procedures and so contribute to the control of field work.

During an audit, considerable information is obtained, discussed or examined. It is vital that formal records be maintained rather than committing information to memory, where undoubtably some of it would be lost. In addition, audit records serve as an important basis for the auditor's understanding of the auditee's programs, objectives and activities, and as such can be used as support for orderly discussion with operating personnel.

Finally, working papers provide coherence to the numerous individual procedures comprising any given audit.

d) Facilitating review and reporting to superiors

Uniform working paper formats provide an efficient means for the audit team to communicate the results of their work to reviewers. Well-organized papers facilitate review by helping the reviewer spot omissions, deviations from normal procedures and unusual problems which were encountered. Good working papers provide for meaningful communication of key results and conclusions through the summarization of individual details.

Provide support for the auditor's report

In addition to contributing to the effective management of assignments, good working papers provide a vital link between the audit examination procedures and the auditor's report. Working papers represent evidence of the work done and should provide the proof that the examination as summarized in the auditor's report did encompass the areas identified.

Working papers should provide a record of the audit procedures performed in respect of items in the report and the conclusions reached with respect to those items.

Well-structured working papers provide for effective debriefing sessions with auditees, allowing for ready access to pertinent facts and proof supporting audit report commentary.

Finally, good working papers lend themselves to reduced report-writing effort; the continuous process of summarizing and refining individual audit results keeps the assignment focussed and easy to translate to report format.

Provide background and control for follow-up actions

Audit projects are typically followed up to ensure that corrective action was taken for reported deficiencies. Professional working papers provide background information for this task and reduce the likelihood of duplication of effort.

Follow-up can take place any time from a matter of weeks after the audit, or not until the next scheduled assignment. The follow-up action can be controlled, however, through audit working paper documentation and a B/F system.

Facilitating third-party review

Internal audit working papers can be used by external auditors or other interested third parties as a means of evaluating the work of internal audit and in the external reviewer's assessment of the department's system of control.

The Auditor General and Central agency evaluation groups have been the primary users of audit information in the past. With the introduction of the Access to Information Act, however, there may be increased use of working papers by the public should they exercise their rights provided by this legislation.

In the eyes of third parties, working papers reflect the quality of the audit work done. Third parties should be able to satisfy themselves from the working papers that a proper audit was carried out. Working papers must be prepared with this in mind.

It is important, therefore, that the working papers provide a complete record of the examination and can be readily understood by third parties. Adequate documentation of planning, background data of the audited entity, control systems, test procedures, results of test work, important discussions with auditees, decisions and conclusions reached, will enable reviewers of working papers to establish the adequacy and appropriateness of the audit procedures performed.

Aiding professional development

The discipline required to create good working papers provides an opportunity for new staff to learn procedures and exercise judgment in arriving at audit conclusions.

Review of the staff's efforts can assist the staff appraisal process, help determine training requirements, and identify situations where staff are ready to take on additional responsibility.

Providing a source of information for non-audit purposes

Working papers can serve as a repository of information that may assist in non-audit tasks. Audit working papers often provide convenient summarizations of auditee data and may be useful in ways unrelated to the original audit assignment. For example, models of the management control framework may be helpful to auditees as planning input for system design changes or as a training device for their staff. Also, the work done by auditors may be useful as input to other studies such as those performed by program evaluators.

CHAPTER THREE

GENERAL PRINCIPLES RELATING TO WORKING PAPERS

The most important principles relating to audit working papers are:

- economy
- clarity
- relevance
- accuracy
- completeness
- simplicity
- balance

Economy

Working papers should be prepared with economy in mind: economical to prepare and review, to store and retrieve.

Working papers should be a usable record of work done, spare but complete and not a repository for every scrap of information available to the auditor. The professional auditor includes only what is essential and makes each worksheet serve a purpose that fits into the audit objectives. Poor judgment in the extent of information retained will make working paper preparation, review, storage and retrieval uneconomical.

Clarity

Working papers should be readily understandable and require no supplementary information. Reviewers of the papers should be able to determine what the auditors set out to do, what they found, what was concluded and what was not done.

Relevance

Working papers should relate to matters which are pertinent and material. They should be directly related to the audit objectives. The likelihood of important

information being overlooked or obscured is minimized when care is taken to include only that information relevant and sufficient to satisfy audit objectives.

Indiscriminate filing of information is not only inefficient, but may lead to problems in responding to requests under the Access to Information Act. With the inclusion of irrelevant data, uninitiated reviewers may misinterpret or confuse the meaning of the content within the working papers.

Accuracy

Working papers should be prepared accurately, ensuring that observations and comments are specific, valid and objective. The working papers should provide reviewers with the proper perspective of the processes being examined.

Oral comments obtained during the course of the audit should be paraphrased by auditors and a summary interpretation of the meaning of the comments should be included within the working papers. To ensure that there is no misunderstanding and that audit documentation is accurate, the auditee should be asked to confirm the auditor's interpretations.

Completeness

Working papers should record (a) for information obtained, all relevant and material facts and their source, (b) for audit procedures, their nature, timing, extent, results and the name of the auditor who performed them and (c) for audit conclusions, the conclusions and the basis for arriving at those conclusions.

An inquiry should not be dropped without explanation.

Simplicity

Working papers should be comprehensible to the uninitiated reviewer. Jargon should be avoided or properly defined where necessary.

Balance

Working papers should reflect all findings including positive results as well as any deficiencies on which action should be taken.

Balanced working papers reduce the likelihood of a distorted impression being left with reviewers as to the adequacy of the management control framework under review. In addition, balanced working papers provide the proper basis for an effective audit report.

CHAPTER FOUR

AUDIT WORKING PAPER CONTENTS

Working papers should document the entire audit process, commencing with the planning stage and following through the stages of review, evaluation, verification and reporting.

Each of these stages of the audit process has been described in Chapter 7 of the Standards for Internal Audit and in The Guide to the Development and Conduct of Audit Assignments. Some restatement of information from these documents has been made in this paper to clarify the nature of the various working papers generated in each stage of the audit. A study of working papers cannot be separated from the audit activities they are meant to facilitate and record.

This chapter describes the necessary documentation that should result from each stage of the audit process and indicates the primary purposes served by various working paper documents. The next chapter will provide guidance as to how the necessary working paper content should be organized into permanent or current working paper files. The reader should also recognize that the principles outlined in the previous chapter should be carefully applied to each document prepared for inclusion in the working papers.

In addition to the following narrative comments relating to audit documentation, Table 1 summarizes the various purposes of each working paper document.

Assignment Planning Phase

The principal documents arising from this phase are:

- background information relating to the nature, characteristics and boundaries of the audit entity; and
- the assignment planning memorandum.

Table 1

Audit Working Paper Purposes Audit Working Paper Contents	Effective Conduct and Mgt. of Assignment	Support for Auditor's Report	Background for Follow-up	Third Party Review	Aid for Professional Development	Non-Audit Purposes	Retention	
							Current File	Permanent File
<u>Assignment Planning Phase</u>								
Background Data	P			S		S		X
Planning Memo	P	S	S	S	S		X	X(A)
<u>Review Phase</u>								
Detailed Documentation of Existing Control Framework	P			S		S	X	X(A)
Predetermined Control Model	P	S		S	S		X	X(A)
Control Questionnaires	P	S		S	S		X	
Register of Essential Controls	S	P		S			X	
Register of Compensating Controls	S	P		S			X	
Summary of Control Weaknesses	S	P	P	S			X	
<u>Evaluation Phase</u>								
Documentation as to the Adequacy of Controls	S	P		S			X	
Verification Plan Procedures and Results	S	P		S			X	
Cause and Effect Analysis	S	P		S			X	
Summaries of Audit Observations, Conclusions, Recommendations	S	P	S	S			X	

(For explanation of symbols see next page.)

Table 1

Audit Working Paper Purposes Audit Working Paper Contents	Effective Conduct and Mgt. of Assignment	Support for Auditor's Report	Background for Follow-up	Third Party Review	Aid for Professional Development	Non-Audit Purposes	Retention	
							Current File	Permanent File
<u>Reporting Phase</u>								
Supervisory Review Checklists and Notes	P			S	S		X	
Debriefing Notes	P	P		S			X	
Draft Audit Report	P	P		S			X	
Final Audit Report			P	S			X	X(A)
Management Responses and Action Plans	P		P	S			X	X(A)
Follow-up Notes	P		P	S			X	X(A)

P - primary purpose served by the working paper

S - secondary purpose served by the working paper

(A) - information is relevant to supporting the assessments of the specific assignment, but is also of continuing interest; information may be retained in both files or carried forward from current file to permanent file.

a) Background information

In formulating the scope parameters of the assignment the team leader must develop a good working knowledge and understanding of the audit entity. The gathering of background information serves the auditor with various reference points for deriving an overall appreciation of the audited entity.

All background information which provides the auditor and subsequent reviewers with a summary of relevant current facts, policies, systems and organizational structures pertaining to the audit entity should be retained in the working papers. The period of retention will be discussed in subsequent sections of this paper but the criteria generally applicable is that the background information retained is current and of continuing relevance.

A description of typical background information gathered by the auditor is outlined in Appendix A of this report.

b) Assignment planning memorandum

The assignment planning memorandum is the principal document of the planning phase of the audit. It should provide a documented summary of planning information, audit considerations, assumptions and decisions taken.

In that the memorandum establishes the overall plan for the audit, it is vital for facilitating the effective management of the assignment, serving as a basis for planning and conducting all subsequent phases of the audit.

The memorandum also serves as a useful reference point for discussions held with auditees and for subsequent reviewers of the assignment.

The principal components of the assignment planning memorandum are outlined in Appendix A.

Review Phase

The principal documents arising from this phase are:

- detailed descriptions of programs, objectives and activities under review;
- predetermined control models;
- control questionnaires, decision tables or other techniques used to identify the existence of controls relative to the predetermined control model;
- criteria relating to the evaluation of the adequacy of controls; and
- working papers which summarize:
 - essential controls
 - compensating controls
 - control weaknesses.

a) Detailed descriptions

In the review phase, the gathering of detailed descriptions relating to the management control framework can be viewed as an extension of the background information gathering activities of the assignment planning phase. This documentation serves as the basis for the auditor's understanding of the auditee's programs, objectives and activities and as such, can be used as support for discussion with operating personnel. In addition, the discipline required in preparing these working papers serves as a necessary audit control technique, helping auditors to clarify to themselves and reviewers their understanding of the entity under review.

Modelling techniques are often used in displaying the review phase documentation in the working papers. Models are presented typically as either narrative systems descriptions, organization and responsibility diagrams or outline and procedural flowcharts. The systems and processes of the audit entity most often addressed include program structure and logic, the management control framework and the organizational structure and accountability relationships.

As a necessary control, working papers should include documentation of the validation procedures employed to verify the relevance, completeness and accuracy of the data collected.

b) Predetermined control model

The documented predetermined control model provides the basis or framework for evaluating the effectiveness of the audit entity's processes under review. This documentation is a critical dimension of the evaluative process, setting out the auditor's expectations relating to the control objectives that should be achieved within the entity under review.

Related to the predetermined control model, the working papers should set out the techniques that will be used to elicit information relating to whether controls actually exist for the various control objectives set out in the model. Frequently used techniques include control questionnaires or checklists.

Criteria that will be used during the evaluation phase of the audit should be refined and documented in the working papers during the review phase. These evaluation criteria relate to the means by which an auditor will assess whether the results of existing controls are achieving the desired control objectives.

The predetermined control model and the evaluation criteria should be discussed with the auditee during the review phase or earlier, if the opportunity exists. In addition to keeping the auditee fully informed, this discussion will seek to elicit any concerns or disagreements the auditee may have with the proposed framework of the evaluative process. Where these concerns are significant, it may be necessary to re-evaluate or modify the audit approach to incorporate management's suggestions or concerns. The working papers should provide a complete record of this discussion so that subsequent reviewers can determine whether adequate steps were taken by the auditor in seeking agreement as to the premises underlying the evaluative aspects of the assignment. Such evidence will lend greater credibility to the standards used by the auditor in the evaluation of the adequacy of controls and performance of the entity under audit.

c) Application of the control model

At this stage in the assignment, the auditor will normally apply the control questionnaire (or related technique) to determine whether there is an actual control in place for each of the essential control objectives. Control questions may be answered

from existing systems documentation or through further limited discussion with the auditee.

Where controls related to control objectives are identified they should be specifically documented in the working papers. A convenient means of recording controls which the auditor considers necessary to effective operations is through the use of the Register of Essential Controls, a type of worksheet illustrated in Appendix B.

This working paper serves as a useful summary to auditors and reviewers, and provides:

- a means of documenting in an organized manner the controls in existence;
- a means of identifying those controls considered essential;
- a record from which procedures and tests can be developed to substantiate the effectiveness of controls;
- a record of the results of substantive testing; and
- a record of weaknesses identified in the operation of essential controls.

When a control is not identified for a control objective the auditor should establish if part of the control framework has been missed in the original documentation of the system, or if compensating controls exist. The documentation of compensating controls can be documented on a worksheet such as the Register of Compensating Controls, illustrated in Appendix B. Essentially this worksheet serves purposes similar to the Register of Essential Controls, however it highlights that control objectives are not directly served by certain controls but are met through the secondary effects of compensating controls.

Where no adequate compensating controls are found during the limited review, the auditor must assume that a deficiency or weakness exists. These weaknesses may be documented on a worksheet such as the Summary of Weaknesses, also illustrated in Appendix B.

The principal purpose of these worksheets is to ensure that control strengths and weaknesses identified are recognized in developing evaluation and verification procedures and/or formulating audit findings.

Evaluation Phase

The principal documents arising from this phase are:

- control questionnaires or related techniques designed to determine whether identified controls are operating effectively;
- supporting documentation relating to the application of the above questionnaire;
- a verification plan, procedures and results;
- cause and effect analysis for identified control weaknesses; and
- audit observation, conclusion and recommendation worksheets.

a) Documentation of the effectiveness of controls

In evaluating the adequacy of identified controls, the auditor will assess whether these controls are achieving desired results. To do this, the auditor uses the management control objectives and the evaluation criteria established in the review phase as a basis upon which to answer the questions:

- is the control being used as intended?
- is data supplied by the control system accurate, representative and timely?
- is the existing control framework appropriate to the entity?

To elicit answers to these questions, the auditor will normally prepare a control questionnaire which focusses on specific results of controls in place. At this point in the audit, these questionnaires are applied to the information gathered during the review phase.

The results from the application of the control questionnaire and limited tests should be documented as the basis for audit findings as to the effectiveness of existing controls.

Based on the findings derived to this point in the audit, the auditor may be in a position to conclude that certain controls exist and are operating effectively. If so, this conclusion should be documented and the auditor need not consider further documentation relating to this control until the reporting phase. Conversely, the auditor may find that controls do not exist or are operating ineffectively. In such cases the auditor will document these findings and will proceed with cause and effect analysis as described below.

In many cases however, the auditor may be faced with two problems:

- a) the information on hand does not sufficiently corroborate the tentative conclusions or findings reached to this point; and
- b) some questions relating to the effectiveness of controls are impossible to answer without additional information.

In such cases the auditor must determine detailed verification tests necessary to arrive at a position where definite findings or conclusions can be made, at which time the examination can then proceed to cause and effect analysis or the reporting phase. The decision as to whether or not the auditor has sufficient evidence to provide a satisfactory conclusion relating to the effectiveness of controls is a difficult one that requires professional judgment on the part of the auditor. This subject matter goes beyond the intended scope of this paper, but will be separately addressed in a subsequent paper on audit evidence. The audit working papers, however, should clearly document the auditor's decision-making process, the findings and conclusions relating to the study of the effectiveness of controls.

- b) Cause and effect analysis

On completion of the necessary procedures to substantiate existing controls and significant deficiencies, inefficiencies and weaknesses, the auditor will be in possession of a body of audit findings recorded on worksheets such as the Register of Essential

Controls, the Register of Compensating Controls and the Summary of Weaknesses. To develop audit findings, conclusions and recommendations for reporting purposes, the causes and effects of control deficiencies must be analyzed. The focus of this analysis is to substantiate hypotheses on the reasons for, and significance of, failure to match the specified audit criteria.

Audit working papers should document:

- a) a clear statement of the problem revealed by an audit finding or group of findings. This statement should be supported through reference to control weaknesses noted in the course of the review and evaluation phases and substantiated in the verification phase; and
- b) a clear statement of cause and effect substantiated through further analysis and limited testing as necessary. Effects will usually be derived through reference to the control objectives outlined in the predetermined control model.
- c) Summarization of audit findings, conclusions and recommendations

For each area/activity subject to audit, the auditor should now have accumulated a list of findings, substantiated by verification procedures and analysed for cause and effect where controls were found deficient. Summarization of these findings is a useful control for auditors, substantiating to reviewers that the scope of the audit has been satisfactorily covered and concluded upon. Summaries are beneficial in tying together groups of working papers relating to a particular issue. Relating summary findings to the original planning memorandum ensures that all significant areas have been covered.

Summaries also act as a mechanical control over the underlying working papers. They provide the important link between the audit report and detailed supporting working papers.

Reporting Phase

The principal documentation of this phase includes:

- supervisory review checklists and notes;
- working papers relating to the presentation of audit findings to the auditee;
- draft audit report;
- final audit report; and
- management responses to audit findings, action plans and audit report follow-up notes.

a) Supervisory review

Audit working papers should be reviewed on a regular on-going basis by the team leader as the audit progresses. As a minimum, the audit manager should review working papers at the completion of the assignment planning phase and again, at the completion of the audit team's development of findings, conclusions and recommendations.

In the working papers, it is informative to retain evidence of the supervisory review. Inclusion of supervisory review checklists, duly signed off, will provide a record of the basis by which review took place. Review checklists should indicate at minimum that the reviewer is satisfied that:

- the scope of coverage has been adequate;
- the working papers documentation is complete; and
- appropriate evidence has been obtained and documented to support audit findings and conclusions.

Additional areas encompassed by the review may include:

- that only material relevant to audit objectives has been retained in the working papers; and

- working paper information is properly organized and will facilitate third-party review should the need arise.

Proper review of the working papers is a necessary quality control measure, helping to ensure that established standards of audit conduct are maintained and that budgets and deadlines are met. Review may also provide secondary benefits by ensuring that concise, relevant, accurate and complete information is available and easily retrievable in the working papers for external reviewers such as the Auditor General, Central agency evaluation groups, program evaluation staff, or the general public who exercise their rights under the Access to Information Act.

Detailed review notes are sometimes retained in the working papers along with the review checklists and reviewer conclusions. Presuming that reviewers ensure that working papers are completed to the point where all review notes have been adequately cleared, retention of the review notes is typically unnecessary.

b) Presentation of audit findings to the auditee

There should be a continuous dialogue between auditors and auditee management throughout the course of the audit assignment. There are, however, certain formal communication requirements, one of which is the requirement for the team leader to provide auditee management with a summary of audit findings and recommendations prior to drafting the final report.

Once the team leader is satisfied that all working papers have been completed and reviewed and a summary of audit findings, conclusions and recommendations prepared, a meeting with the appropriate auditee should be arranged.

Working papers should provide evidence that the auditor provided auditee management with an opportunity to review the results of the audit prior to the time that the auditors left the audit site.

The working papers should illustrate the audit findings discussed and the auditee's reactions. This will serve to:

- a) lend greater credibility to the audit findings that will be included in the final report. After the exit review there may be disagreement on conclusions and recommendations included in the draft audit report but there should seldom be disagreement or subsequent surprises on factual matters;
 - b) provide assurance to reviewers that the auditor has taken steps to ensure that all relevant facts related to the audit findings were considered in reaching conclusions; and
 - c) provide evidence that auditees were informed on a timely basis of findings, thereby allowing them the earliest opportunity to initiate corrective action.
- c) Preparation of the draft and final audit reports

There is no standard or universal model for the audit report. However, all reports should incorporate the following elements:

- an outline of the audit objectives and scope including any limitations to scope;
- a brief description of the audit approach followed;
- an overview of the audit entity in sufficient detail to convey that the auditor has gained a good general perception of the nature of the entity, and the environment in which it operates; and,
- a summary of the major findings, conclusions and recommendations which states clearly the nature of the problem, the causes, the implications and the action's to be taken by each level of management, as necessary.

In preparing the report the team leader must ensure that the audit findings are adequately supported by evidence contained in the working papers. A working copy of the draft report should be cross-referenced to the supporting working papers to facilitate reference to the evidence that is backing the findings and conclusions.

The audit report should include only relevant and significant information expressed logically and concisely, and addressed clearly to those who have the responsibility for initiating corrective action.

Draft reports represent part of the decision-making process which culminates in the final audit report. In a sense, the draft report is a more formal presentation of audit findings to the auditee and essentially serves the same purposes as the exit debriefing, but in a more formal manner.

The receipt of formal responses from auditees to the draft material presented by the auditor may be considered to serve a purpose similar to the external auditor's use of the "letter of representation". The confirmation by the auditee of the validity and appropriateness of the auditor's findings and conclusions serves as an additional and necessary form of substantiation in ensuring that the final audit report is presented as objectively as possible and includes all relevant facts. This process also serves to ensure that changes within the audited entity from the time of the auditor's debriefing may be communicated to the auditors for their consideration before preparing the final audit report. The use of an actual letter of representation adapted for internal audit purposes is being studied by the OCG. If necessary, further comment on this subject will be provided through a future Policy Interpretation Notice.

The final report represents the ultimate product of the audit process and should be retained in the working papers. Once the final audit report has been issued, the senior executive responsible for the entity audited should require the preparation of appropriate action plans. A copy of these plans should be forwarded to the internal audit group for review and comment. This plan should contain implementation dates and be retained in the working papers.

During the course of the implementation of the action plan the auditor should monitor progress reports and retain them on file for the sake of completeness. The working papers should reflect evidence that the usual role adopted by the auditors in follow-up was properly discharged. In this regard, the auditor normally advises senior management as to the acceptability of corrective action taken by line management in response to audit findings and recommendations. Working papers should indicate the auditor's conclusions as to whether implementation of the action plans has been

satisfactory and where necessary, document inadequate action. The steps taken by the auditor in ensuring that senior management remained informed until adequate action was taken should be provided in the working papers.

Occasionally, a separate follow-up audit may be warranted. In this situation a detailed memo outlining the circumstances should be prepared so that additional work may be included in the long-term plan and the annual schedules. The working papers should include points for follow-up as reference to any future audits to be performed in the area.

A detailed treatment of follow-up procedures is beyond the scope of this paper but will be the subject of a future paper.

CHAPTER FIVE

STRUCTURE AND ORGANIZATION OF WORKING PAPERS

As noted in the section relating to the purposes of working papers a number of useful effects can be achieved through maintenance of well-structured files.

Proper organization of working papers can lead to benefits such as:

- allowing several individuals or separate offices to work on different segments of an assignment in a co-ordinated manner;
- bringing discipline to the audit approach, reducing the chance of omissions in the review of complex systems;
- serving as a tool for instruction to audit staff;
- facilitating efficient communication of results; and
- facilitating review by helping to isolate deviations from normal procedures.

This section does not propose detailed guidance relating to the structure of working papers but will identify procedures in common usage that serve to meet the purposes noted above.

General Organizational Principles

A uniform policy for the organization of working papers should be established within the audit group. Uniformity in the type of files maintained, stationery used, indexing and general layout of working papers allows for many of the benefits noted above, particularly the advantages of providing for proper co-ordination between auditors and for efficient reference and review.

Working papers are usually divided into two types of files: permanent and current. The organization of files into these types segregates background information of continuing interest that relates to the audit entity from that information which

supports the auditor's current assessment of the adequacy of the management control framework under review.

The allocation of the various working papers accumulated or prepared during the audit between these two groups of files varies in practice. Generally, certain types of information are associated with either permanent or current working papers and this breakdown is identified in Table 1.

In practice, some variation in the content of permanent versus current working papers can occur. Differences in treatment generally relate to the extent of information of continuing interest that is maintained in the permanent file or included on schedules in the current working papers. Certain schedules retained in the current file that relate to the current assessment of the audited entity may be of use in the planning of a subsequent assignment. As a standard procedure, the audit group may designate that all such schedules in the current file need not be retained in the permanent file but simply carried forward at the time of the subsequent assignment.

Proper organization of working papers could accept either treatment. Consistency, however, in the manner by which working papers are divided by the audit group is extremely important. Reviewers of current working papers must have assurance that there has been no misfiling of evidence in support of individual assignment reports. Conversely, where certain information of continuing interest is filed in current working papers, the audit group must establish a procedure that ensures the information will be carried forward to subsequent assignments. Proper carry-forward procedures are particularly important if different retention practices are established for current and permanent working paper contents.

Auditors usually maintain other files, such as correspondence files. For the purpose of this paper, these files are not considered to be audit working papers since they do not normally contain papers of continuing interest or information directly supporting the auditor's report. When they do contain such papers, copies of or references to them should be included in the working papers because audit working paper files should be complete in themselves.

Indexing and Cross-Referencing

Finding information in the working paper files is best facilitated by an index system and liberal use of cross-referencing.

The system of indexing should be simple and flexible. One such system is to use a capital letter to designate broad segments of the audit and numerals for the worksheets within the segments. Appendix C illustrates an indexing system and reflects how it can be readily expanded to accommodate a large body of working papers.

The indexing system should be known at the beginning of an assignment to avoid the situation where an auditor is faced with a mass of unreferenced papers. To keep working papers referenced on an ongoing basis the audit team leader should assign index references at the same time that tasks are assigned.

Cross-referencing related data within the working papers greatly facilitates review and provides ready access to supporting information during debriefing sessions. Cross-referencing audit plans to procedures applied, audit programs to the results of tests and the audit report to supporting evidence are examples of typical areas where this technique is most useful to prime users and reviewers of audit files.

The cross-referencing system uses the indexing references assigned to working papers. One method of cross-referencing commonly employed places significance on the location of the reference. References appearing to the left of the correlated data indicates the working paper from which the information was derived. References to the right of correlated data indicates the working paper to which the information is being carried forward.

Example A figure, 1234.56, is referenced from working paper K2 to draft report page A4

a) on K2 the reference would be:
 1234.56 A4

b) on A4 the reference would be
 K2 1234.56

Cross-references, of course, are not restricted to tying figures together but are applied liberally to all related information contained in separate working papers. Appendix C illustrates how various segments of the working papers can be correlated.

Headings

The headings on individual working papers should facilitate the proper filing of the papers and the locating of specific information, and should enable the reviewer of the papers to determine who prepared them. Each paper should therefore include:

- period of examination
- title, subject or description of working paper
- date of preparation
- initials of the preparer
- initials of the reviewer
- indexing and cross-referencing codes.

Segregation of sensitive information

With the introduction of the Access to Information Act, internal auditors should pay particular attention to information accumulated within working papers that should not be disclosed should there be a request under the Act (reference should be made to the Policy Interpretation Notice issued by the OCG entitled Treatment of Access to Information Requests for Audit Information).

To allow for efficient processing of access to information requests, the internal audit group should initially review the nature of the subject matter of the assignment and determine the extent of exempt or excluded information that will likely be accumulated in the working papers. Where little of such information is associated with an assignment, the internal audit group need not be concerned with segregation of sensitive material until a specific request is received. Alternatively, where it is expected that considerable exempt or excluded data will be accumulated during the assignment, the internal audit group may wish to segregate sensitive information from the working papers as they are prepared or accumulated. Where, in the auditor's judgment, a request for information is likely to be received and there is considerable

exempt or excluded information associated with an assignment, greater efficiency in processing the request will be achieved by segregating sensitive information as the working papers are prepared. If a request is then received, only the segregated material needs to be reviewed in determining the extent of information that can be disclosed.

When segregation of sensitive information is performed as the working papers are being prepared, the main body of working papers could include a number of "dummy worksheets" which indicate the nature of sensitive information that is being held separately. Where such information is related to data included in the main body of working papers, the dummy worksheets could contain cross-references to that data to ease review and retrieval. In that the head of a government institution is not required to indicate the existence of a record which is not disclosed, the dummy worksheets themselves may also be withheld from disclosure when they relate to excluded or exempt information.

CHAPTER SIX

RETENTION AND DISPOSAL

Authority for Disposal

The revised TBS records management policy (refer to TBS circular no.: 1983-09) provides a broad definition of public records so that most types of audit working paper documentation would be considered to be included within its scope. When this policy is read in conjunction with the Public Records Order (P.C. 1966-1749) virtually all documented audit information, regardless of physical form, made or received in pursuance of federal law or in connection with the transaction of public business, falls within the scope of the policy's provisions.

With the inclusion of audit working papers within the scope of the TBS records management policy, audit groups must not destroy records or permit their removal from the control of the Government of Canada except in accordance with the schedules approved by the Dominion Archivist.

Although audit groups do not have authority to dispose of working papers outside of the provisions of the records management policy, they still retain special knowledge about the retention value of audit working papers. As such, audit groups working through their departmental records management system have a responsibility to advise on necessary retention cycles to ensure that storage of working papers is done economically and efficiently.

The following section provides guidance as to the method by which auditors can review the retention value of working papers for the purpose of advising departmental records management personnel. At present, Schedule 2 of the General Records Disposal Schedules, approved by the Dominion Archivist, establishes a six-year retention cycle (two years current; four years dormant) for audit working papers. This standard and the existing retention practices adopted within the internal audit community are being studied by the OCG for adequacy. At the conclusion of this study, more definitive guidance will be provided regarding proper retention cycles. Until such time, the six-year retention standard should be applied to all audit working papers content, adjusted for longer cycles where there exists additional value as described in the following section.

Evaluating Working Papers for Retention Value

Because the storage of working papers can require a great deal of costly space, the determination of the proper retention period constitutes a practical problem for audit groups. Retention should be guided by a review of the continuing value associated with working papers.

In evaluating working papers, four primary types of value should be considered. These are:

- administrative value
- legal value
- fiscal value
- informational data value.

Administrative Value

The administrative value in records may be defined as those records required to carry out the current activities of the audit group.

All working papers contribute to the proper administration and conduct of an audit. As has been illustrated throughout this paper, the orderly accumulation of audit information serves a number of purposes relating to the effective completion of an audit assignment. Once an audit is complete however, determination of the continuing administrative value of working papers represents a difficult problem for auditors.

In assessing working paper records for any remaining administrative value, the auditor should consider the following questions for each record and, when the answers are "YES", then the records will be considered to have no more administrative value:

- (a) Has the record ceased to contribute to the administrative performance of the function which it supported?
- (b) Has the original purpose of the record been fulfilled?
- (c) Is the record being retained as a convenience or because it has been the practice to keep it?

- (d) Has the transaction within each individual record been completed?
- (e) Has the record been kept merely to guard against administrative blame?
- (f) Is the record available elsewhere, i.e., is it duplicated?

Legal Value

The legal value in records may be defined as those records which involve long or short term rights of the government or of the private citizen and which are enforceable by the courts.

The retention of internal audit working papers in the public sector because of their legal value is less predominant than in the private sector where an action for tort or breach of contract is an important consideration for external auditors.

Nevertheless, specific legal requirements should be determined by the auditor to ensure that retention practices protect the legal rights of the department and individuals.

Fiscal Value

The fiscal value in records may be defined as those records which departments require to show how moneys were obtained, allotted, controlled and expended.

Audit working paper retention has been traditionally associated with their fiscal value. In the General Records Disposal Schedules (approved by the Dominion Archivist and issued under the authority of the Public Records Order P.C. 1966-1749) audit working papers were given a six-year retention cycle in order to protect their underlying fiscal value. This practice has been carried over from external audit practice and may be of questionable relevance in the federal government environment.

Informational Data Value

This multi-purpose value may be defined as the ability of a record to aid in the reconstruction of the past activities of a department, to provide information for current and future planning, and to furnish data upon which new activities may be based.

Much of the information retained in working papers has some informational data value. For the internal audit group, certain aspects of working papers, typically included in the permanent working paper files, are of continuing use in the planning and conduct of future assignments. All audit information pertaining to the last assignment at a specific audited entity has value to external reviewers, particularly the Auditor General, for establishing a basis upon which the activities of the internal audit group can be evaluated. With the increasing emphasis placed by the Auditor General upon relying on the results of internal audit work, recognition of the continuing informational data value of working papers is significant when establishing proper retention cycles.

CHAPTER SEVEN

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- Circular No.: 1983-09, Records Management Policy, Treasury Board Secretariat; March 22, 1983.
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1. Interdepartmental Advisory Committee on Internal Audit (IACIA), Internal Audit Handbook, Volume II, Book 1, Chapter 1, Exposure draft: "Guide to the Development and Conduct of Audit Assignments".

2. Office of the Comptroller General, Policy Development Branch, Position paper: "Treatment of Access to Information Requests for Audit Information".

BACKGROUND INFORMATION GATHERED DURING THE ASSIGNMENT PLANNING PHASE

To obtain an overall appreciation of the audited entity, the auditor will normally obtain and include within the working paper documentation:

- significant legal, financial and regulatory constraints that impact upon the audited entity including as sources such documents as the Main Estimates, legislation, regulations and Central agency policy;
- environmental information including the objectives and activities of all organizations affecting the operations under review;
- previous studies and audit reports that have either directly or indirectly had an effect on the operations of the auditee;
- internal information for both the audited entity and the department, such as:
 - organization charts and position descriptions;
 - delegation of authorities documents;
 - significant financial and other operating data including long-term and annual plans, budgets and variance reports, management reports, person-year allocations and performance measurement reports.

ASSIGNMENT PLANNING MEMORANDUM

An assignment planning memorandum should include as a minimum:

- a summary of the scope and objectives of the assignment and any limitations placed thereon;

- an overview description of the audit entity encompassing:
 - legislative authorities and mandate;
 - key objectives and goals;
 - resources employed (human, financial and physical);
 - key organizational/operational issues and constraints;
 - principal information and control systems;
 - principal management control mechanisms;
 - significant changes in operations/system/influences over the past two years or since the last audit; and,
 - known/expected future influences on the audit entity.
- principal issues and anticipated lines of audit enquiry;
- audit strategy decisions including the audit approach and general notes on audit techniques decisions;
- basic audit objectives and associated criteria developed;
- outline of audit report format(s) taking into account levels of reporting required;
- resource requirements including identification of specialist skills;
- time budget and critical milestone dates;
- assignment of staff responsibilities;
- any other significant considerations or outstanding issues; and,
- confirmation of approval to proceed.

REGISTER OF ESSENTIAL CONTROLS

Prepared by: _____

Reviewed by: _____

WORKING PAPER REFERENCE	NATURE OF ESSENTIAL CONTROL	NATURE OF VERIFICATION TEST		RESULTS OF VERIFICATION AUDIT PROCEDURES	WEAKNESSES DEFICIENCIES REFERRED TO SUMMARY OF WEAKNESSES
		Basis/Sample Size	Reference To Verification Audit Procedures		

SUMMARY OF WEAKNESSES

Prepared by:

Reviewed by:

[illegible]

REGISTER OF COMPENSATING CONTROLS

Prepared by: _____

Reviewed by: _____

WORKING PAPER REFERENCE	COMPENSATING CONTROLS		
	Description	Flow Chart/Systems Document Reference	Verification Procedure Reference

Appendix C

ILLUSTRATION OF INDEXING/CROSS-REFERENCING SYSTEM FOR WORKING PAPERS

CURRENT WORKING PAPER FILES

<u>Subject</u>	(1) <u>Index</u>	<u>References to</u>	(2) <u>References from</u>
<u>General/Administration (File 1)</u>			
Final Report; Final management letter	A	-	C, D, G
Management comments and action plans	B	A	source (3),
Follow-up notes	C	B	source
Draft report; Draft management letter	D	A	E, G
Verbal debriefing - notes	E	D	source
Supervisory review checklists and notes	F	(4)	(4)
Summary of audit observations, conclusions and recommendations (including cause/ effect analysis)	G	A, D	J, K, L
Assignment Planning Memorandum	H	(5)	(5)
Correspondence	I	as necessary	source

(For explanation of symbols see next page.)

<u>Subject</u>	(5) <u>Index</u>	<u>References to</u>	(1) <u>References from</u>
<u>Supporting Working Papers (File 2)</u>			
Register of Essential Controls	J	G	N, Q
Register of Compensating Controls	K	G	N, Q
Summary of Weaknesses	L	G	N, Q
Control Questionnaires	M	N	O
Documentation in response to control questionnaires	N	P	if conclusive - J, K, L if inconclusive - Q
Predetermined control model	O	M	source
Documentation of existing control framework	P	N	source
Verification plan, procedures, results	Q	J, K, L	N, source

Explanatory Comments

- (1) expansion of index - each page of the section can be referenced simply as A1, A2, A3 etc., if a worksheet is to be added between A2 and A3, the A2 becomes A2.1 and the added sheet can be indexed A2.2.

- | | |
|-------------------|---|
| (2) references to | - information contained in this section supports or provides background for the content of the section to which the reviewer is being referred; |
| references from | - information contained in this section is supported by the content of the section from which the reviewer is being referred. |

For ease of review, working papers should be cross-referenced in a manner reflecting the relationships between sections as noted above. Working papers should build upwards from source data to the final audit report.

- | | |
|------------------------------------|---|
| (3) source | - indicates that information is derived directly from the audited entity through discussion, observation or application of audit procedures. |
| (4) supervisory review checklists | - normally checklist is signed off indicating that a satisfactory standard of quality has been achieved in the audit and adequately reflected in the working papers. |
| (5) assignment planning memorandum | - various aspects of the memo may be referenced to supporting working papers indicating to the reviewer that planning decisions and scope were taken into consideration during the conduct of the assignment. |

PERMANENT WORKING PAPER FILES

<u>Subject</u>	<u>Index</u>
<u>General Information</u>	AA
<ul style="list-style-type: none"> significant legal, financial and regulatory constraints that impact the audited entity; environmental information on organizations that effect the operations of the audited entity. 	
<u>Operational Base for Audited Entity</u>	BB
<ul style="list-style-type: none"> objectives of the auditee departmental and internal plans relevant policies and procedures reporting requirements services provided organization chart, position descriptions capital and operating budgets performance standards. 	
<u>Operational Documentation for Audited Entity</u>	CC
<ul style="list-style-type: none"> systems documentation (program logic, management control framework, accountability relationships). 	
<u>Previous Studies or Reports</u>	DD
<ul style="list-style-type: none"> copies of previous audit reports, follow-up notes, management action plans, planning memorandum; copies of all recent AG reports, departmental responses 	

SubjectIndex

other internal departmental or Central Agency evaluation group studies or reports.

DD

The above list is meant to be illustrative and not restrictive in any way. Additional significant information should be included as necessary.



No. 1983-03
Date: 01-09-83

**Internal Audit
Policy Interpretation Notice**

Subject: PRINCIPLES FOR INTERNAL AUDIT FOLLOW-UP ACTIVITY

Office of the Comptroller General

Policy Development Branch
Internal Audit and Special
Studies Division

PURPOSE AND SCOPE

The purpose of this Policy Interpretation Notice (PIN) is to propose a set of principles for follow-up activity which supplements Internal Audit Standard No. 23. The proposed principles are discussed in more detail in the attached Position Paper. These may be used to guide departmental internal audit follow-up activity directly, or as a reference for the development of departmental policy/guidelines for this activity.

ISSUES

The major issues related to follow-up activity include scope, timing, frequency, depth, roles and purposes.

The role of internal audit as a control function, whose purpose is to review, verify and evaluate other organizational controls, is now reasonably well understood and accepted by most departmental and agency management. The continuation of that role beyond the audit report stage does not yet have the same degree of acceptance in all departments. This is due to the lack of agreement on the nature and extent of follow-up activity, and the varied approaches to its implementation. This is not surprising since the nature and extent of follow-up activity that is desirable is largely situation dependent.

Questions concerning this notice should be directed to:

INTERNAL AUDIT AND SPECIAL STUDIES DIVISION
POLICY DEVELOPMENT BRANCH
OFFICE OF THE COMPTROLLER GENERAL
(613) 996-6171 or 995-1297

INTERPRETATION NOTICE POSITION

The principles suggested for guiding follow-up activity in departments and agencies are:

1. Internal audit functions should plan for and execute follow-up action on all audit observations and associated recommendations recorded in internal audit reports.
2. Action plan development and implementation is the responsibility of management and the timing of follow-up action should coincide with normal managerial control points.
3. Follow-up activity for any specific audit entity should normally terminate when it has been overtaken by the next planning cycle. This provision is subject to modification by the Audit Committee where such action is deemed to be justified. This general principle does not preclude repeat audits.
4. There is intrinsic value in maintaining on-going contact with the auditee.

The Position Paper suggests that departments and agencies incorporate a requirement for action plan development and implementation, and associated follow-up activity in their internal audit policy and associated procedures, where they have not already done so. These activities are crucial to the effectiveness of the internal audit function.

DISPOSITION

The internal audit community is requested to provide comments to IASSD on the Position Paper. It is suggested that internal audit groups compare their existing follow-up practices to the principles recommended in the Position Paper and report instances where the suggestions provided will not achieve the effects intended.

Ultimately, the final position on audit follow-up will be incorporated within the standards or IACIA Internal Audit Handbook, as appropriate. Monitoring of follow-up practices in departments relative to the final position taken on audit documentation will be performed as part of the performance assurance review program of IASSD.

PRINCIPLES FOR INTERNAL AUDIT

FOLLOW-UP ACTIVITY

A Position Paper

in support of PIN 1983-03

Policy Development Branch
Internal Audit and
Special Studies Division

1. INTRODUCTION

The role of the internal audit function, as the evaluator of management controls, is now reasonably well understood and accepted in most departments and agencies. Unfortunately, management's perception of the product of that role often tends to revolve around the internal audit report to the exclusion of other, equally relevant products such as those of the follow-up process. Consequently, the role of audit beyond the report stage does not yet have the same degree of acceptance in all departments. This is partly due to the lack of agreement on the nature and extent of follow-up activity that is desirable, and the varied approach to its implementation. This is not surprising since the nature and extent of follow-up activity that is desirable is largely situation dependent.

2. PURPOSE AND SCOPE

The purpose of this Position Paper is to propose a set of principles for follow-up activity which are meant to aid departmental decision-making as to the scope, timing, frequency, depth, roles and purposes of internal audit follow-up activity.

3. APPROACH

As mentioned, it is difficult to adopt precise, yet widely applicable rules for follow-up activity since it is situation dependent. Nevertheless, it is assumed there is general agreement that such an activity is desirable, and that providing some structure for it has utility and that it is possible to agree on the general principles which should guide its implementation.

What follows is a set of tentative principles proposed along with descriptions of their intent and rationale. The intention is that through an iterative series of dialogue, attempted use and feed-back steps we will arrive at a set of principles to guide the implementation of follow-up activity in departments and agencies, regardless of situation dependent parameters.

4. PROPOSED PRINCIPLES

Principle

- 4.1 Internal audit functions should plan for and execute follow-up action on all audit observations and associated recommendations recorded in internal audit reports.

Discussion

The follow-up process can only be delineated in conjunction with the final stage of the audit assignment process-report writing.

To simplify matters it is assumed that obtaining management's response (reaction to the finding, conclusion or recommendation) is a mandatory part of the report writing stage of the audit assignment process. This would make the development of management's action plan the first stage of the follow-up process, whether the action plan is incorporated into the internal audit report or not. Although the auditor may be called upon for clarification of contents during action plan development, the first formal internal audit activity in the follow-up process will normally be action plan review.

The nature, timing and frequency of follow-up action will depend on the substantive content of the audit conclusion and associated recommendation (its significance), and will vary with the stage in the process, with the milestones provided in the action plan, and with the sophistication of the departmental management process.

An essential component of the first stage is obtaining agreement from management that it intends to undertake corrective action. This may involve several stages of discussion and negotiation through the managerial hierarchy up to and including the Audit Committee and, in extreme cases, the deputy head alone. Other possible elements of the follow-up process include:

- (a) Desk Review Of Periodic Progress Reports: Minimum frequency to be set by departmental policy; individual cases may be determined by departmental management or by the Audit Committee; in any case it should not be less frequent than semi-annually and should be more frequent at the front end, as deviations get progressively more costly to correct. Desk Review is the minimum follow-up action recommended.
- (b) Periodic On-site Review of Progress on Action Plans: Frequency should be determined on the merits of individual cases. It is expected that a mixed desk/on-site review strategy will prove optimal.
- (c) On-site Review: (follow-up audit) of action plan implementation to determine if anticipated improvements were achieved.
- (d) Poll of Managers: To determine if the action plan's implementation resulted in the anticipated improvements.
- (e) Regular Audit: Include as part of the scope of the next regular audit of the auditee area in question.

All of these follow-up process elements have potential value in encouraging action plan implementation, and as review mechanisms which enable the head of internal audit to provide advice to the deputy head. However, the two results oriented reviews, (c) & (d) and the repeat audit case, (e) could be used as indicators of effectiveness of

the internal audit function as well. In fact one could make a strong case for on-site results reviews as being the means for determining the ultimate indicators of internal audit function effectiveness - all others being proxy-measures. The main weakness of that case would be the joint responsibility problem, which makes it difficult to distinguish between managements' and auditors' relative contribution.

Not all of the elements of the follow-up process would be justifiable in all cases. For example, those elements requiring on-site review are obviously more costly and would have to be weighed against the benefits foreseen. In any case, the extent of follow-up and use to which results are put should be a decision of the deputy head, on the advice of the Audit Committee, with appropriate input from the head of internal audit.

The requirement for follow-up, the respective roles and responsibilities, and minimum frequency requirements should be embodied in departmental internal audit policy and associated procedures.

Principles

- 4.2 Action plan development and implementation is the responsibility of management and the timing of follow-up action should coincide with normal managerial control points.
- 4.3 Follow-up activity for any specific audit entity should normally terminate when it has been overtaken by the succeeding departmental planning cycle. This provision is subject to modification by the Audit Committee where such action is deemed to be justified by circumstances. This general principle does not preclude repeat audits.

Discussion

The head of internal audit is a staff adviser to management, particularly senior management. Follow-up activity contributes to this advice role. It is up to management to plan, implement and control the action plan. Therefore, the progress reports received by internal audit should be on a "copy to" basis, with the original destined for higher level management rather than being a "special" report created solely for the audit group. Normal superior-subordinate relationships should prevail; the purpose of the report being copied to the internal audit group is so that the head of internal audit can play the expected advice role. On-site reviews should be synchronized with associated management reviews, where possible.

In cases where an auditee area has a good plan implementation track record, all outstanding action plan items that have not been implemented at the time of the next planning cycle should automatically be overtaken by (included in) the plan for the coming period and, therefore, not need further follow-up by internal audit. This is, of course, the ideal case. In practice, there may be any number of reasons for continuing the follow-up activity. This decision has to be weighed against the resentment generated against unwarranted interference with on-going managerial processes (whether real or perceived). In any case, the impact of an audit conclusion, and associated recommendation decreases with time.

Principle

- 4.4 There is intrinsic value in maintaining on-going contact with the auditee.

Discussion

The intrinsic value of on-going contact is undeniable, however, it may be carried out in many guises. If there is an on-going need for follow-up activity, it is simply more efficient to combine liaison and follow-up activities. If, on the other hand, follow-up is not justified, liaison can continue on its own merits, without the associated negative aura of control activity.

5. CONCLUSIONS

In conclusion, although action plan development and implementation, which results from internal audit recommendations is the responsibility of the auditee (i.e. management), the internal auditor has the usual associated responsibility of advising the deputy head/Audit Committee as to the adequacy of those processes.

To establish or strengthen the follow-up process it is suggested that departments and agencies incorporate the requirement for action-plan development, follow-up activity, and associated roles and responsibilities of both management and internal audit, in their internal audit policies and procedures.



No. 1984-01
Date: 10-03-84

Internal Audit
Policy Interpretation Notice

Subject: AUDITOR JUDGEMENT

Office of the Comptroller General

Policy Development Branch
Internal Audit and Special
Studies Division

PURPOSE AND SCOPE

The purpose of this Policy Interpretation Notice (PIN) is to provide the internal audit community with guidance related to auditor judgement; it supplements standards 16 and 17 dealing with "due care" and sufficiency of evidence respectively.

ISSUES

Auditor judgement has always been a significant element of the audit process. In the relatively unstructured environment of broad scope auditing it is even more pervasive. Unfortunately the discussion of auditor judgement generally has not had much explicit, individual treatment in audit literature. An exception to this is a recent exposure draft, CGA - Canada, Auditing Standard No. 2, Auditor Judgement, issued by the Certified General Accountants Association of Canada (CGA). (The CGA is in the process of issuing a series of standards, which are meant to supplement existing professional and statutory standards, i.e. GAAS/GAAP.)

INTERPRETATION NOTICE POSITION

Although the CGA standards are written for private sector, external auditors, Auditing Standard No. 2 is considered sufficiently relevant to internal auditing to suggest it as recommended reading for all internal auditors as well. (See Attachment)

Questions concerning this notice should be directed to:

INTERNAL AUDIT AND SPECIAL STUDIES DIVISION
POLICY DEVELOPMENT BRANCH
OFFICE OF THE COMPTROLLER GENERAL
(613) 996-6171 or 995-1297

DISPOSITION

Our intention is to incorporate the most relevant ideas presented in CGA Auditing Standard No. 2 in a chapter on Auditor Judgement in Volume II of the IACIA, Internal Audit Handbook (IAH).

The internal audit community is invited to provide comments to IA&SSD on the attached draft standard, in the context of its applicability to internal auditing, with a view to influencing the content of the proposed chapter for the Handbook.

Questions, commentary and suggestions may be directed to IA&SSD's policy development officers Mark Cuddy or Ernie Chadler at (613) 996-6171.

CGA-Canada

Auditing Standard No. 2

AUDITOR JUDGEMENT

INTRODUCTION

- 1.1 Absolute assurance is not possible in an audit due to the nature of testing, the limitations of internal control and the fact that much audit evidence tends to be persuasive rather than conclusive. Therefore, **professional judgement** is an integral part of any audit.
- 1.2 Auditor judgement is a professional judgement which depends on the qualifications of the auditor. First, an auditor must possess professional qualifications combined with adequate practical experience, and second, the auditor must possess an independent state of mind. He must undertake to perform his work with the skill, care, and caution which a reasonably competent, careful and cautious auditor would use. Implicit in this undertaking is the expectation that the auditor will exercise a high level of judgement.
- 1.3 Flexibility of judgement can be contrasted with rigidity of regulations. The balance between judgement and regulation is important. It is clear that auditing generally requires more professional judgement than does accounting. In the end, the auditing process is summarized by two judgements which are required in the auditor's report: that the accounting consistently satisfies generally accepted accounting principles (GAAP) and that the auditing meets generally accepted auditing standards (GAAS).

OBJECTIVES

- 2.1 As pointed out in the introduction, it is necessary to balance the relationship between professional judgements, and accounting or auditing regulations. These relationships must be **operationally specified** in order to be of direct use to practitioners. Auditor judgement has become increasingly important because of the sheer volume of information, the expansion in the number and sophistication of users of audited reports and the responsibility that auditors bear to society as a whole.
- 2.2 This Standard is a response to the need for guidance which concentrates specifically on auditor judgement. This Standard indicates a need to use models and other types of structured decision aids to supplement the auditor's subjective judgement process. In addition, this Standard provides a basis for explaining, justifying or defending auditor judgements to parties who might question those judgements. These parties include auditors' superiors, peers, subordinates, as well as regulatory agencies and the courts. Furthermore, operational specification of auditor judgement procedures will provide input for policy making and standard setting in the profession as a whole. Finally, benefits will accrue to parties outside the individual auditors, auditing firms and auditing profession.

AUDITOR JUDGEMENT ISSUES

- 3.1 The judgement performance of auditors is increasing the subject of judicial scrutiny, and certain conclusions can be drawn from the results of cases heard in Canada, the United Kingdom, and the United States. First, the courts seem willing to let the profession articulate accounting and auditing standards, but they are inclined to look beyond conformity to standards for answers to the basic question: whether or not the financial statements fairly and meaningfully inform the reader. Second, the courts are demanding that statements disclose information which is intelligible and helpful to people who are not trained accountants. Finally, the courts are increasingly aware that the function of the auditor is to ascribe credibility to the assertions of those who are being evaluated in the financial statements.
- 3.2 In practice, the courts are often called upon to decide on the question of whether or not procedures were followed which indicate "due professional care." It is given that no suggested auditing procedure can be held out to be invariably necessary on all audits, and it is not necessarily sufficient in any given audit. Accordingly, the auditors' professional judgements are directly questioned and judged.

Auditors must be able to explain and defend their judgements.

- 3.3 One of the key problems in auditor judgement is the determination of the **amount** of evidence which should be accumulated; resolution is comprised of two basic steps. First, it must be decided what overall level of assurance is appropriate in the circumstances. Second, it must be decided how much evidence is necessary to achieve the overall level of assurance, considering existing circumstances.
- 3.4 The overall level of assurance is the subjective determination of level of confidence that the auditor has in the fair presentation of the financial statements. Complete assurance of the accuracy of the financial statements is not possible, but reasonably high levels can be obtained. Auditors need guidance in systematically arriving at the overall level of assurance and in determining what the individual sections of the audit contribute to this overall level.
- 3.5 In general, more evidence must be obtained as the level of assurance required by the auditor increases. However, at some point, the additional cost of acquiring more evidence exceeds the benefit obtained from the additional information. Again, some objective criteria are needed to measure or evaluate when evidence gathering has reached a level which will assure achievement of the overall level of assurance.

Auditors should use objective guidance in determining the appropriate overall level of assurance and the evidence required to achieve this level.

- 3.6 Another problem area for auditor judgement is in the drawing of **conclusions** from audit observations and sampling procedures. The avoidance of invalid conclusions or projections requires not only the **disciplined use of logic** but also the careful exercise of professional judgement.

Auditors should use objective guidance in drawing valid conclusions from audit samples and observations.

- 3.7 Finally, the auditor has a responsibility to apply **procedures** which, in his judgement, meet generally accepted auditing standards and comply with the rules of professional conduct. The auditor needs specific guidance in order to do so.

Auditors should use objective guidance in deciding when the requirements of GAAS are met.

- 3.8 Notwithstanding paragraphs 3.5 to 3.7, subjective evaluation is an important aspect of auditor judgement. Objective guidelines should be considered as a supplement to subjective judgement by the auditor.

EVALUATION OF AUDITOR JUDGEMENT

- 4.1 A considerable amount of research has been done on various aspects of auditor judgement. This research can be classified into four areas: internal control evaluation (and subsequent testing); probability assessment (of error rates and account balances); the use of rules-of-thumb (in both probability assessment and the evaluation of sample outcomes); and judgements about materiality or disclosure alternatives. Because accuracy is not directly measurable, various other criteria have been used to evaluate the effectiveness of auditor judgements.
- 4.2 One criterion of effectiveness is stability over time of decisions made by the same auditor using the same information. Lack of stability is considered undesirable for a number of practical reasons, including the potential exposure to legal liability and other sanctions.
- 4.3 Consensus across different auditors within the same firm or across different firms within the profession is another criterion of audit efficiency and effectiveness. In fact, the profession engages in various efforts that are intended to promote consensus (for example, the educational and licensing requirements of the profession). Research indicates a strong positive association between consensus and accuracy. Auditors whose decisions agree with those of other auditors tend to be

more accurate on average than auditors whose decisions disagree with those of other auditors. These results are based on situations where accuracy can effectively be measured. Furthermore, it is assumed that consistency also promotes accuracy in auditing contexts where no good measure of accuracy is available.

- 4.4 A third criterion for the evaluation of auditor judgement is insight and the auditor's understanding of his decision process. Such insight and understanding is usually the product of knowledge and experience applied with disciplined logic. A high degree of self-insight into the judgement process is critical when the supervision of an audit involves delegation and staff training.
- 4.5 A final criterion for evaluating auditor judgement is consistency with professional auditing standards. Some standards are sufficiently precise to serve as criteria for evaluation (for example, the principle that the extent of substantive testing required to obtain sufficient evidence should vary inversely with the auditor's reliance on internal control).

Criteria for evaluating the effectiveness of auditor judgement include:

- Stability over time;
- Consensus among auditors;
- Insight into the decision process; and
- Consistency with auditing standards.

- 4.6 In assessing systems of internal control, substantial individual differences have been found among auditors who are evaluating the same information. Notwithstanding these assessment differences, the reliability of internal control does affect auditors' judgement regarding the accuracy of records, and therefore, the subsequent test work and sample sizes.

Auditors must plan test work and sample sizes according to their assessment of the reliability of internal control systems.

- 4.7 Earnings trends and assets size are important factors in materiality judgements. However, studies reveal that "the effect on income" dominates materiality disclosure judgement in many cases to such an extent, that all other factors are virtually ignored.

Auditors must guard against utilizing a single criterion in materiality judgement decisions. Thus, auditors may depend on "the effect on income" for materiality judgements, but not to the exclusion of other factors.

METHODS TO IMPROVE AUDITOR JUDGEMENTS

- 5.1 In general, it can be said that auditors must maintain a healthy scepticism about their own judgements, just as they maintain an attitude of scepticism about their clients' financial information. A sceptical attitude encourages auditors to seek ways to improve their judgements.
- 5.2 One way to improve auditor judgement is for auditors to understand the characteristics and limitations of human decision-making. Auditors should be aware of (and accept) the fact that human decision-making involves potential problems, and accordingly be willing to monitor their own decision-making with these potential problems in mind.
- 5.3 A natural extension to the awareness of human decision-making problems is the utilization of educational programs (as part of student training and professional development) which are designed to help auditors overcome these problems. Such educational efforts could include, for example, training in statistical and probabilistic concepts, as well as exposure to the results of research studies on auditor decision-making.
- 5.4 A related possibility is providing auditors with feedback about their judgement decisions. A "track record" for each auditor is often not feasible, because decision accuracy cannot be measured. However, it is possible to provide feedback which does not require knowledge of "correct" answers. Information about auditors' decision-making processes can be provided to indicate the extent to which the auditors employ each item of information in decision-making. This information could be used as part of education or training efforts in auditor judgements. Results of monitoring decision-making efforts can be utilized to improve auditor judgements by changing the information which auditors employ to make the judgements. This activity would include the elimination of information which is **not** useful for the decision.
- 5.5 An important and practical technique for improving auditor judgement is the use of models to supplement (or even replace) human decision-making in repetitive decision contexts. Examples include statistical decision models and multiple regression models of the environment. The primary advantage of such models is the enhancement of stability of decisions over time, and consensus among auditors. An input information model (such as multiple regression) will produce consistent output, in the form of evaluations, predictions or choices. The model output can be accepted "as is" or can serve as additional input to the auditors' judgement processes. The auditor must be aware, however, that a high correlation achieved through these models does not necessarily imply that there is a valid relationship.
- 5.6 Another way of reducing the inconsistency of individual judgements is to form teams of two or more individuals. For example, it has been shown that the accuracy of equally-weighted composite decisions is at

least as great as the mean accuracy of the decisions of individuals. Where a number of people are engaged in the audit, the gathering of composite information would be of training value, as well as of significant use in improving auditor judgements.

Auditor judgements can be improved by:

- Training in decision-making;
- Monitoring decisions and providing feedback;
- Utilizing decision models to supplement human decision-making; and
- Utilizing team decision-making.

REASONABLE AUDIT ASSURANCE

- 6.1 Because certainty is not an attainable goal of the audit function, what is sought is reasonable audit assurance (sometimes called overall audit assurance). The goal of reasonable audit assurance is accomplished through the use of professional judgement and the consideration and evaluation of critical factors.
- 6.2 Auditors must seek a reasonable level of assurance as a minimum on all engagements and must seek an even higher level on sensitive engagements. The appropriate level of overall auditor assurance must be determined by auditor judgement, because it is difficult to measure levels of assurance and it is unreasonable to expect that every auditor will demand the same level of evidence under similar circumstances. Auditors differ, both as to the risks they are willing to accept and as to their level of experience and competence.
- 6.3 The reasonable audit assurance principle is concerned with the confidence the auditor has that the statements present fairly the financial position of the entity, and the results of its operations. Generally speaking, the higher the level of assurance the auditor demands, the more evidence he must obtain. The important decision to be made is at what point does the additional cost of acquiring more evidence exceed the benefit obtained from the additional information.

- Reasonable audit assurance refers to the overall confidence that the statements present fairly the financial position of the entity and the results of its operations.
- Generally, the higher the level of assurance demanded, the more evidence that must be obtained.

- 6.4 Many auditors assert that it is not possible to quantify the overall assurance achieved in an audit. These auditors acknowledge that it is practical to obtain measures of the level of assurance for some individual audit procedures (for example, by using statistical sampling) but that many audit procedures do not lend themselves to objective measurement. Also, these

auditors feel that there are no means of objectively determining, from individual segments, the overall level of assurance. Therefore, they argue that the level of assurance is highly subjective and determined purely by auditor judgement. However, the modern view, where auditing is considered more scientific than was typical of the past, advocates that (while auditor judgement is certainly necessary) guidelines and objectives models are of assistance to auditors.

Guidelines and models should be used to assist auditor judgement in the selection and measurement of a reasonable level of audit assurance.

- 6.5 Some overall influences on the level of assurance should be considered. Fee constraints and competition among auditing firms may influence the level of assurance downward. However, (the threat of) lawsuits, professional sanctions and professional pride keep the overall level of assurance high and reasonably uniform across the profession.
- 6.6 Different levels of assurance are appropriate for different circumstances. When it is known that heavy reliance will be placed upon the financial statements, it is appropriate that the auditor's overall level of assurance be increased. The cost of additional evidence can be justified when the potential loss to users (from material errors) is substantial. The degree to which statements will be relied upon is a function of the client's size, distribution of the client's ownership and the nature and amount of client liabilities. When a client organization is in an illiquid, unprofitable or over-levered condition, it is reasonable to increase the level of overall audit assurance. When the business is of a risky type or when the competence of management is in question, overall audit assurance levels should be increased.

The level of reasonable audit assurance should be increased when:

- Heavy reliance will be placed on the statements;
- The client is illiquid, unprofitable or over-levered;
- The business is risky; or
- The competence of management is in question.

- 6.7 The three critical factors which determine what is a reasonable level of overall audit assurance are the audit assurance factor, the specific risk factor, and the relative risk factor.
- 6.8 The audit assurance factor refers to the degree that an account (or a group of accounts) contributes to the credibility of the financial statements as a whole. The view taken is that the financial statements as a whole achieve the overall audit goal of reasonable audit assurance.

- 6.9 The specific risk factor is concerned with the fact that certain assets, accounts and transactions are, because of their nature, more susceptible to fraudulent manipulation and theft. Accordingly, auditors traditionally consider these specific, risky items for extra review. Examples of such items are cash, negotiable instruments, and inventories which have a common use or demand. The specific risk factor is also related to the risk of special circumstances, such as the prospective sale of the business or the poor financial condition of the client.

- 6.10 The relative risk factor is concerned with the internal control system and the audit procedures. A judgement must be made with respect to the probability of an error or loss occurring that the system of internal control would not detect. Then, a judgement must be made as to the probability that the (internal or external) audit procedures may not detect the error or loss.

The level of reasonable audit assurance should be determined by evaluation of:

- The audit assurance factor,
- The specific risk factor, and
- The relative risk factor.

MATERIALITY

- 7.1 One of the most basic functions of auditor judgement is the determination of the materiality limit, or the threshold which is established for each audit engagement. The materiality limit is used as a guide to planning the nature and extent of the verification procedures, and for assessing the sufficiency of audit evidence. Finally, the materiality limit influences the appropriate audit opinion to be expressed. Operationally, the materiality limit chosen will affect decisions regarding sample size and decisions involving which items do (or do not) warrant exhaustive verification procedures.
- 7.2 Most auditors agree that guidelines can be used to assist in establishing materiality limits for a given audit. Absolute amounts are not generally useful as materiality guidelines because, for example, \$25,000 might be material for a small firm, but not a large company. Relative guidelines are generally used, based either on the account itself, a group of accounts, or the total assets or total equities. Materiality relative to reported income is an important consideration. For example, an error which is not material with respect to total inventories might be material with respect to reported income. In not-for-profit organizations, the magnitude of what is material can best be gauged by reference to either total revenues or total expenditures (the difference between the two usually being minor). Use of measures of profitability for materiality levels is often inappropriate, because net income may fluctuate widely from year to year. It may not make sense, for example, to halve the materiality level when profits drop by 50%. This difficulty can be avoided by

reference to normal (or normalized) net income as a base. More often, gross margin is used as a base for materiality decisions.

Materiality guidelines should be established which relate to the magnitude of (groups of) assets, equities, revenues and expenses (or expenditures).

- 7.3 All organizations **will not** have the same materiality guidelines. Most materiality decisions are made in the context of the impact of errors which will mis-state net income and net assets. In addition, consideration should be given to errors of classification among balance sheet components or income statement components. Materiality in errors of classification is important, particularly where the misclassification will distort financial ratios. When the auditor has made his judgement concerning materiality limits, it is usually prudent to discuss the planned materiality with the client's management, directors or audit committee.

- Materiality guidelines for each audit should relate to the size, type and nature of the client organization.
- The materiality limit determined during the planning stage is tentative and subject to review and change as evidence is gathered.

INTERNAL CONTROL SYSTEM DECISIONS

- 8.1 In the context of reasonable audit assurance, a critical auditor judgement must be made as to whether or not a specific account, or group of transactions, should be subjected to formal review of the internal control. In the absence of other indications (e.g., statutory requirements, suspicion of fraud, specific requests by the client), auditor judgement is required, since all accounts should not be treated alike.
- 8.2 To bring some objectivity to auditor judgements on internal control reviews, decision aids are useful. Exhibit I is an example of a professional judgement guideline for the purpose of account selection for the review of internal control. However, such a guideline should only be used in the context of a sound planning and control system, as illustrated in the *CGA Public Practice Manual, Volume II*.
- 8.3 Use of Exhibit I requires that each account be listed separately and an auditor judgement made (major to minor) for each of the three factors (audit assurance, specific risk and relative risk) as they pertain to that account. A 3-point ranking scale is then applied as follows:
- Weighting of 3 for a major consideration;
 - Weighting of 2 for an in-between consideration;
 - Weighting of 1 for a minor consideration.
- The three weightings can then be summed (for a total three to nine points) and a threshold of the total figure

established. This figure will aid the auditor in his decision as to whether plans should be made for internal control review, or only minor consideration of any particular account. Internal control review programs can then be selected (see for example, the relevant sections of the *CGA Public Practice Manual, Volume II*) for the accounts judged to require reviews of the internal control systems.

Auditors should use decision aids to strengthen professional judgements regarding the need for review of internal control systems.

AUDIT PLANNING DECISIONS

- 9.1 One of the most significant decisions to be made in planning an audit is the degree of reliance that can be placed on the internal control systems. The level of reliance on internal control is particularly important where internal control has an impact on the measurement of major income figures.
- 9.2 Where it is appropriate to place considerable reliance on a particular control area, auditors should identify specific key control feature (or features) on which reliance is placed. This will assist in designing compliance procedures to cover the particular control area.
- 9.3 For the determination of audit procedures, decision aids can assist auditor judgement and bring some objectivity into the process. Exhibit II is an example of a weighted-value decision aid (similar to the decision aid for making internal control review decisions) which can be used to assist in the planning of audit procedures and evidence-gathering. The same scaling system and critical factors are used as in Exhibit I (paragraph 8.3) with the addition of the results of the decision on the level of reliance which can be placed on internal control. (Presumably, for the same account, the scaling for the three critical factors, audit assurance, specific risk, and relative risk, will be the same as for the internal control selection guideline.) The values for the four factors are totalled (from four to twelve) and thresholds set to assist in planning audit procedures for each account. The apparent double-counting of internal control in Exhibit 2 is designed to ensure that accounts which are rigorously examined. The established internal control figure determined in Exhibit I is re-evaluated in Exhibit 2 in the context of the account selection and investigation function. Segmented audit procedures can result from a full **Audit Program** (probably selected from *CGA Public Practice Manual, Volume II*), to a **Review Program** (perhaps selected from *CGA Public Practice Manual, Volume I*), to a **tailor-made program**, to a simple, minor consideration to the account.
- 9.4 It is important to emphasize that professional judgement guidelines should not be used indiscriminately. The auditor must start with professional competence and independence. He must then acquire an understanding of the specific circumstances surrounding the client firm. In the absence of negative evidence in a specific direction to the contrary, the auditor must

consider critical factors (perhaps using a decision aid) in order to arrive at a conclusion based on professional judgement.

- 9.5 A critical auditor judgement is whether or not to accept a particular engagement. To adequately make a decision, auditors could use a questionnaire-style guideline. Such a guideline should require consideration of facts such as whether or not the auditor is sufficiently qualified, independent, or capable of completing the engagement. Also, consideration of the need to inquire of the prior auditor and the need to make inquiries and hold discussions with the client should be incorporated into a professional judgement guideline. In addition, a similar methodology could be used to ascertain if the client is auditable.
- 9.6 A judgement guideline is useful in considering the utilization of the client's resources. Auditors should utilize client resources to the fullest extent in all areas. However, the auditor must exercise care to ensure the reliability of information provided by the client and to ensure that work which should be conducted by the audit staff is not delegated to the client. The auditor can enhance the results of client's work by providing detailed instructions and working papers to client staff. Examples of work which can be completed by client staff are preparation of systems flow charts, schedules and analyses and the provision of special documentation.
- 9.7 Auditors can use a relationship approach as a professional judgement guideline to assist in the selection of accounts for audit investigation. Using the relationship approach, the auditor would determine that an account would be selected if its dollar value represented, for example, more than ten percent of the total dollar value of all assets in its class. In auditing transactions, an auditor might select an individual entry if its dollar value represented, for example, more than five percent of the total value of the account. Alternatively, a specific value approach can be used as a professional judgement guideline in the selection of accounts for audit investigation. Using this approach, the auditor would determine that any account over a specific dollar amount be selected for investigation, regardless of relationship factors. This method is often applied arbitrarily, as a complement to other methods.
- 9.8 Professional judgement guidelines can be of assistance in an auditor's sampling decisions. It can be assumed that random sample selection is better than any other method, and that the better the system of internal control, the more reliance can be placed on sample results. Assuming internal control is adequate, satisfactory results from a primary sample would support a decision to discontinue sampling in that field. Past history of errors increases the probability of current errors (unless remedial action has taken place) and, similarly, the absence of past errors reduces the probability of current errors (unless intervening systems changes have occurred).

- 9.9 Professional judgement guidelines can be used to assist in auditor judgements regarding the reduction or omission of substantive verification checks. For example, if the prior year's audit investigation indicated that internal control systems were in place and operating effectively, and the current year's review of internal control systems substantiates that the systems are still in place, then an auditor may decide that certain checks be reduced or, even omitted. In such circumstances the auditor would reinforce his professional judgement with valid, documented evidence, which would not only support his decision but also show clearly that the reduction or omission was intended; and not the result of error or negligence.

Auditors should utilize professional judgement guidelines or decision aids to determine and document:

- The type and nature of audit procedures;
- Whether to accept a new engagement;
- How to use client staff and resources;
- The selection of accounts or transactions for audit investigation;
- The selection of samples; and
- The reduction or omission of substantive checks.

UTILIZATION OF DECISION AIDS

- 10.1 As implied in paragraph 4.3, audit decisions have been found to lack a high degree of consistency across auditors, and to be insensitive to various statistical and probabilistic features of the information upon which the decisions are based. Most of these problems relate to the auditor's attempt to integrate large amounts of information judgementally. It is suggested that one way to improve auditor judgement is to include training in decision-making in formal training programs for auditors and auditing firms.
- 10.2 To supplement formal training, firms can establish "judgement policies" in key areas and train the personnel to follow these policies. It is necessary that these policies evolve over time and are modified in response to specific engagements. The main purpose of such decision aids is to increase the consistency (over time and across auditors) with which auditor judgements are made.
- 10.3 Another way of improving auditor judgement is to utilize statistical decision models. A number of repetitive audit decision situations are amenable to the application of decision models. Common aids utilized are: multiple regression and time series models in analytical reviews; statistical sampling (rather than judgemental sampling); and statistical evaluation of sample results. The problem is that statistical decision models are not feasible for many auditing situations.

10.4 Where statistical decision models are not feasible, the use of structured decision aids is appropriate. The use of structured decision aids is not new in auditing. Such aids are used routinely in the information collection phase of an audit (for example, the pervasive use of internal control questionnaires and audit programs). Beyond these simple decision aids there are applications which include information integration, in addition to information collection and review. Structured decision aids are useful for integrating substantial amounts of information, in order to help auditors identify critical combinations of conditions that typically signal weaknesses in internal control and to help auditors decide which of these weaknesses are applicable to the particular control system being investigated. This type of decision aid would typically utilize sets of decision tables. Another example of a structured aid is one designed to specifically focus on the extent of substantive tests. This kind of aid is useful when statistical sampling is not employed. The decision aid relies on a combination of equations and decision tables to integrate different types of information in order to determine non-statistical sample sizes.

In making professional judgements, auditors should utilize decision aids. Decision aids can be classified as:

- Judgement policy manuals;
- Statistical decision models; and
- Structured decision aids.

10.5 The use of structured decision aids is somewhat controversial. The controversy centers around the use of structure versus the use of judgement. Opponents of structured decision aids argue that no two audits are exactly alike and that only a subjective judgemental process (acquired through experience) can be sufficiently sensitive to those aspects of an audit that make it unique.

10.6 Auditors who favor a structured approach to audit decisions maintain that it is better to integrate evidence by a more formal, explicit system than by subjective judgement alone. The structure-view is strongly supported by results of human information processing research in auditing (and in other fields). Several advantages can be given for the use of decision aids. First, both the consistency of audit decisions and their accuracy (if measurable) is improved by augmenting the subjective judgemental nature of audit decision-making with structured decision aids and statistical decision models. Second, by making explicit the factors on which decisions are based, firms are able to foster an organizational responsibility to develop and adhere to judgement policies. Third, structured decision aids provide a basis on which decision-making can be taught. Finally, structured decision aids have been shown to result in favorable cost-benefit results.

10.7 It is important to note that practitioners who favor increased structure maintain that an effective combination of judgement and structure should be sought as the

means of improving audit decision-making. Decision aids do not replace or reduce the need for a judgement. If anything, additional judgement is utilized, because many factors of the judgements must be clearly articulated and this will usually result in the being carefully considered.

10.8 An approach to auditing that establishes an appropriate balance between auditor judgement and structured evaluation is superior to singular auditor judgement. There is a danger, however, of over-use (or inappropriate use) of decision aids. This danger is not created by the decision aids themselves but by inadequate training, supervision and review regarding their use. When used properly, statistical decision models and structured decision aids are effective supplements to auditor judgements.

Auditor decisions are best made by using an appropriate balance between auditor judgement and structured evaluation.

When preparing and issuing CGA Auditing Standards, the CGA Auditing Standards Committee acknowledged that:

- No single rule of general application can be phrased to fit into all circumstances, or combination of circumstances;
- Not every aspect of any Standard can be held to be necessarily applicable in all circumstances, or combination of circumstances; and
- There is no substitute for the exercising of professional judgement in the application of any Standard.

11.0 REFERENCES

- *CGA Public Practice Manual*
- R. H. Ashton, CGA Research Foundation, Monograph No. 6, *Research in Audit Decision Making: Rationale, Evidence and Implications*
- CGA-B.C., *The Audit Engagement: Planning and Control*
- *CICA Handbook*
- *IFAC Auditing Guidelines*
- *AICPA Statements on Auditing Standards*
- R. J. Anderson, *The External Audit*
- Arens, Loebbecke & Lamon, *Auditing: An Integrated Approach: Canadian Third Edition*
- Arens, Loebbecke & Lemon, *Auditing: An Integrated Approach: Canadian Third Edition*

EXHIBIT I: (SAMPLE FORMAT)
Account Selection
Professional Judgement Guideline
Review of Internal Control

Account Group

Client

[illegible]

- * **A.A.** is the audit assurance factor
S.R. is the specific risk factor
R.R. is the relative risk factor

THRESHOLDS:

- five or more indicates a review program;
- four or less indicates minor consideration.

EXHIBIT II: (SAMPLE FORMAT)
Account Selection
Professional Judgement Guideline
Investigative Function

Account Group**Client**

Account Name	Critical Factors*				Total	Decision Audit Program Review Program Minor Consideration
	I.C.	A.A.	S.R.	R.R.		

* I.C. is the evaluation of internal control systems

A.A. is the audit assurance factor

S.R. is the specific risk factor

R.R. is the relative risk factor

THRESHOLDS:

- eight or more indicates an audit program;
- seven to five indicates a review program;
- four or less indicates minor consideration.



No. 1984-02

Date: 01-07-84

**Internal Audit
Policy Interpretation Notice**

Subject: TREATMENT OF ACCESS TO INFORMATION
REQUESTS FOR AUDIT INFORMATION

Office of the Comptroller General

Policy Development Branch
Internal Audit and Special
Studies Division

PURPOSE AND SCOPE

The purpose of this Policy Interpretation Notice (PIN) is to provide the internal audit community with guidance relating to the treatment of requests for audit information made under the Access to Information Act. It is expected that departmental access co-ordinators will seek function-specific advice from the heads of internal audit concerning the release of audit records. Working within the basic tenets of the Act, this PIN identifies a decision-path approach which should enable audit officers to provide consistent and uniform advice to officers responsible for access decisions; advice which meets both the letter and intent of the Act in a meaningful way.

The guidance provided in this PIN supplements the formal policy instructions contained in the Interim Policy Guide, Access to Information Act and the Privacy Act issued by TBS (circular no.: 1983-35). The guidance is not meant to provide an alternative approach to the formal TBS instructions relating to access requests. The formal TBS policy clearly represents the authoritative document for dealing with requests under the Act and should be followed as a normal matter of course in all circumstances.

Questions concerning this notice should be directed to:

INTERNAL AUDIT AND SPECIAL STUDIES DIVISION
POLICY DEVELOPMENT BRANCH
OFFICE OF THE COMPTROLLER GENERAL
(613) 996-6171 or 995-1297

The guidance in this notice was considered necessary because of the impact of the Access to Information Act on the Standards for Internal Audit, particularly standards 17, 20 and 22. The standards relating to audit evidence, assignment reporting and post-audit consultation will be influenced by the release of audit records and as such further internal audit policy interpretation is appropriate.

ISSUES

The Interdepartmental Advisory Committee on Internal Audit felt that a government-wide, general approach to the treatment of requests for audit information would be beneficial in those instances where auditors are asked to give advice to their deputies. Auditors, in such situations, would provide advice which:

- deals with the provision of audit information according to the letter and intent of the law;
- helps applicants satisfy their requirements for audit information in a meaningful way;
- provides a consistent way of dealing with requests for audit records;
- ensures that requests are dealt with in an efficient manner; and
- maintains the integrity of the internal audit function.

The approach presented in this PIN is based upon these intended purposes. Its technical accuracy has been verified through discussions with both Justice Department legal advisers and the Treasury Board's Access to Information Task Force. The approach adopted reiterates the desire on the part of the internal audit community to honour the public's rights to audit information and to be sensitive to their needs. The PIN also explains those limited situations where the auditor may be expected to protect particular kinds of information, the release of which would cause identifiable harm or would be contrary to the law.

INTERPRETATION NOTICE POSITION

Premises

In determining an approach to the treatment of requests for audit information, a number of basic premises were identified. These premises relate largely to the internal audit community's interpretation of the requirements of the Access to Information Act, within the context of the unique features of the internal audit process. They are meant to provide a logical basis from which an approach to information requests can be extracted. Although the premises have been carefully researched and their appropriateness discussed with a number of government officials, including legal advisers, they cannot be claimed to represent a conclusive basis for an approach in the absence of court interpretation of a number of the Act's provisions.

The premises underlying the proposed approach to access requests are:

- a) an ineffective internal audit function will be injurious to the internal decision-making processes of a government institution. In this regard, injury to the internal decision-making processes of the government is most likely to occur when audit information is released prior to the conclusion of the auditor's deliberative process.

Disclosure of audit information prior to the conclusion of the auditor's deliberations may cause harm to the auditee by releasing information which unintentionally misrepresents the nature and state of the operations under review. Such disclosure of audit information will also likely hinder the frank exchange of views between auditors and auditees. Once an audit has been completed, however, the likelihood of injury resulting from disclosure of audit information is significantly diminished;

- b) the auditor's deliberations in arriving at an overall assessment of the auditee's processes and systems are not concluded until the auditee has had the opportunity to comment on the validity, completeness and relevance of the auditor's facts and conclusions presented in a draft report. Appendix A illustrates the audit process as a decision-making process and identifies the nature of the auditor's deliberations;
- c) since the amount of audit information related to any particular request may be extensive, auditors may seek to clarify, through informal discussion with the applicant, the nature of the interest in the audit information. This clarification will serve to localize the information requirement, thereby eliminating unnecessary retrieval, review and edit procedures and helping to reduce the access fee. Informal discussions, however, would only be conducted when the access co-ordinator acknowledges and approves of the nature of discussion intended;
- d) that portion of requested audit documents which contain data prepared for or by the auditee (i.e. source data), will be referred by the auditor to the auditee for determining whether disclosure can be permitted. Using the concept upon which subsection 8(1) of the Act is based, the original source of raw data is assumed to have "greater interest" while the auditor's interest is derivative and, therefore, secondary. Formal use of subsection 8(1), however, would only apply in those situations where the auditee and auditor are employed in different government institutions.

The term "working papers" as used here is consistent with the descriptions provided in the Policy Interpretation Notice, 1983-02, "Audit Working Papers". In that document, draft audit reports are considered to be an integral part of working papers. This understanding of the term working papers is significant to the reader when considering the discussion provided below.

Treatment of Requests for Information

Three possible paths are presented to guide the treatment of requests for internal audit information. The paths are distinguishable by the types of audit documents requested and the stage of the audit at the time the request for information is received. Figure 1 illustrates the following narrative comments in the form of a decision-path flow chart.

DECISION PATH No. 3

DECISION PATH No. 2 & No. 3
(SHARED)

DECISION PATH No. 1

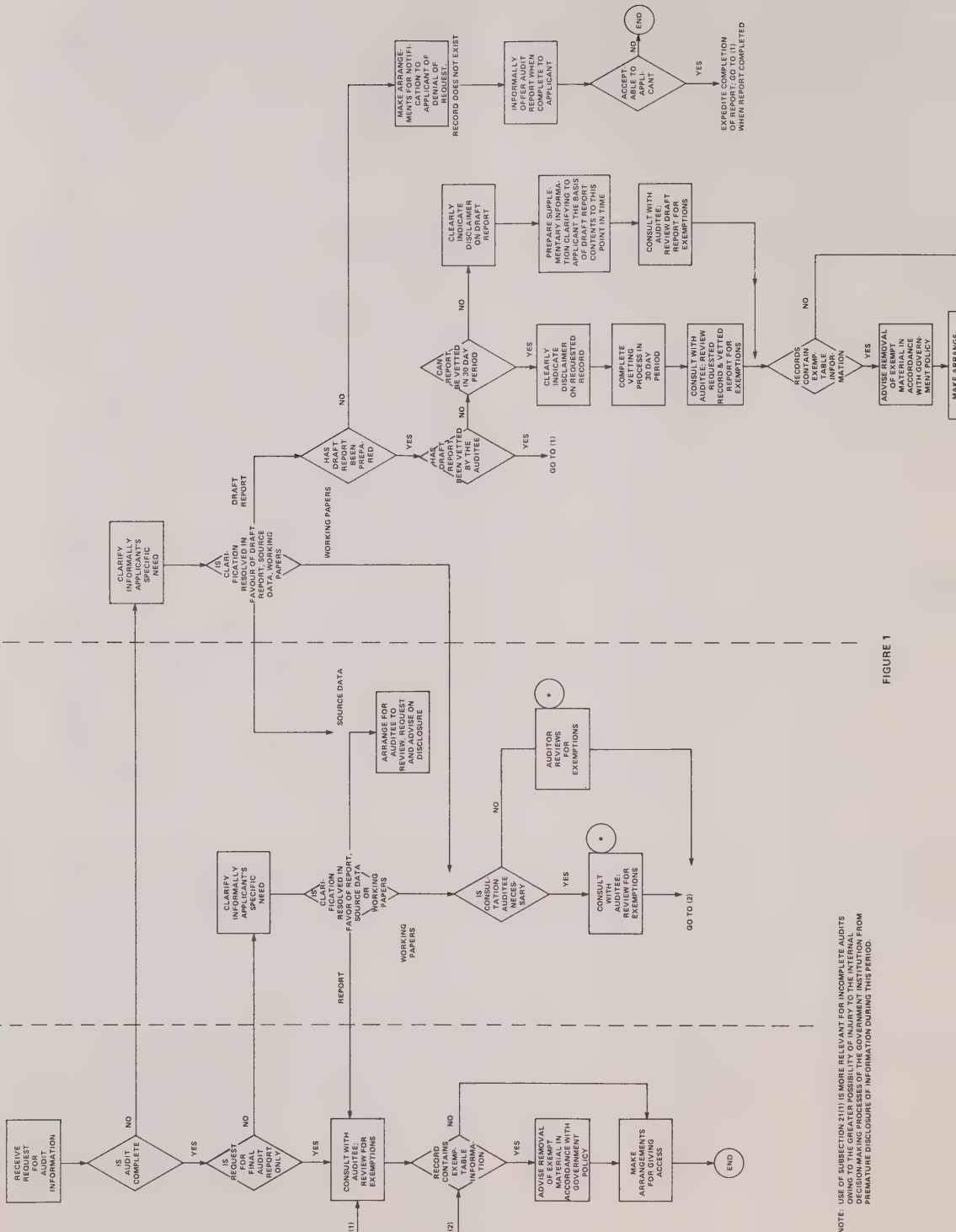


FIGURE 1

* NOTE: USE OF SUBSECTION 21(1) IS MORE RELEVANT FOR INCOMPLETE AUDITS
AND WHERE THE REQUEST FOR INFORMATION IS NOT A REQUEST FOR
PREMATURE DISCLOSURE OF INFORMATION DURING THIS PERIOD.

Decision Path 1

In this scenario, the request for information is received subsequent to the completion of an audit and is clearly directed towards obtaining the final audit report. When this situation occurs, it is suggested that as a general rule, release of the entire audit report be recommended to the deputy head. This disclosure includes the release of recommendations, management's response, and action plans, where it is the practice to include these in the report. Notwithstanding the general rule, auditors may recognize limited instances where conclusions and recommendations contained in the final report include information, the disclosure of which could cause identifiable harm to the internal decision-making processes of the government institution. For such instances, the invocation of paragraph 21(1)(a) may be applicable. For instance, if an institution's decision-making capability is likely to be harmed as a result of disclosing audit conclusions and recommendations, this information should be protected until the likelihood of injury passes. Harm in this context means having a detrimental effect on the specific interest, the decision-making process, covered by this exemption. Although administrative change or embarrassment to public servants could result from disclosure of audit conclusions and recommendations, auditors should note that these effects by themselves are insufficient in demonstrating harm to the decision-making process and therefore do not represent satisfactory grounds for invoking paragraph 21(1)(a).

The general rule favouring full disclosure is thought to be associated with certain benefits. First, full disclosure of the final audit report provides the applicant with a complete and balanced view of the processes under review and minimizes the risk of misinterpretation. The disclosure of auditee comments in response to audit recommendations enhances the credibility of the reported results. The release of the action plans, in response to the audit recommendations, provides evidence of the constructiveness of the audit process. Second, full disclosure of audit reports is also an efficient treatment of requests. Costs associated with editing the contents (severing, per section 25) for release to the public would be limited to those associated with the identification and removal of specific exempt information as noted above.

Audit officers cannot be expected to be aware of all the implications related to the release of information contained in audit reports. Consequently, prior to recommending release of the audit report, the audit officer should consult with the auditees in order to determine whether they feel that there are any legal restrictions relating to disclosure.

For full disclosure of final audit reports to be a practical method of satisfying access to information requests, the auditor must ensure that the existing candor in reporting is maintained. While strong senior departmental management and audit committee support for complete and informative audit reports will in large measure ensure retention of an effective reporting process, auditors must do their part; they must ensure that the quality and integrity of their reports is not adversely affected by the knowledge that the contents may be disclosed to the public.

Decision Path 2

In this scenario, it is assumed that a request for information is received subsequent to the completion of an audit, but is directed towards obtaining audit information not contained in the final audit report.

Initially, the auditor may find it useful to informally attempt to clarify, through discussion with the applicant, the nature of the interest in audit information. Given the broad descriptions provided in the Access Register, the auditor may be able to help applicants localize their information requirement. This could be beneficial in that the volume of information that must be reviewed and edited may be reduced and discussion could help the applicant avoid excessive costs associated with access. Informal discussions, however, should not be seen as an attempt to circumvent the formal processes provided by the Act, and audit officers are advised to consult with their departmental access co-ordinators before proceeding with any discussions with applicants.

Where the applicant's interest can be served by providing source data, the auditor should arrange for the auditee to review the requested information. The auditee should be responsible for advising the deputy head, through the access co-ordinator, as to whether the data can be disclosed. Where the auditor and auditee are employed by different government institutions, the auditor may advise the access co-ordinator that use of subsection 8(1) of the Act may be in order.

Where Audit Services Bureau of Supply and Services Canada performs audits for client audit groups, the decision for disclosure of information will rest with the client department. It is the Audit Services Bureau's policy to transfer requests received directly by them to the client department through the application of subsection 8(1) of the Act. Requests for audit information received directly by the client department will not require the application of subsection 8(1) but the audit group would have to make arrangements with the Audit Service Bureau for retrieval of any audit records stored at their premises.

Where the applicant requires working paper information other than source data, the auditor should review the requested material according to the provisions of the Access to Information Act. Particular attention during this review should be given to the applicability of sections 16, 19, 21 and 22 of the Act. These exemptions and their use are fully described in the TBS Interim Policy Guide and should be carefully reviewed by all auditors. These sections are considered more likely to be associated with the normal contents of working papers than other exemption provisions included in the Act, but emphasis on these sections does not preclude a full consideration of all other exemptions.

Paragraph 21(1)(a) may technically apply to parts of draft reports included within the audit working papers. In addition, paragraph 21(1)(b) could apply to working paper documentation such as interview notes and minutes of meetings between government officials. However, as noted in Decision Path 1, sub-section 21(1) is a discretionary class test exemption and the auditor is advised to determine the existence of harm to the internal decision-making processes when deciding on whether to apply this provision. In this scenario, the audit deliberations have been completed and it is less likely that injury to the internal decision-making processes can be demonstrated. Consequently, under normal circumstances it is expected that paragraphs 21(1)(a) and (b) would not be applied.

Decision Path 3

The most difficult scenario in the treatment of access requests is that situation where a request for audit information is received prior to the completion of the audit. Disclosure of audit information containing tentative observations or conclusions may result in unintentional misrepresentation of the nature and state of the processes under review. Such disclosure would likely hinder the working relationship between the auditor and auditee and ultimately the effectiveness of the auditor's decision-making process which depends to a large extent on the frank exchange of views between auditor and auditee. Equally important, it could do considerable, sometimes irreparable, harm to the auditee. Until the auditee has had an opportunity to comment on the validity, completeness and relevance of the auditor's facts and conclusions as presented in the draft audit report, both the auditee's operations and the audit decision-making process are particularly vulnerable to injury from disclosure of information.

Treatment of request for audit information in this scenario is illustrated according to the timing of the request. Distinctions in terms of approach are based on whether the request is received: before the preparation of the draft report; while the auditor is preparing the draft report or it is being reviewed by the auditee; or after the draft report has been reviewed and verified by the auditee. For all alternative approaches provided in this decision-path scenario, it is assumed that the auditor will initially clarify, through informal discussion with the applicant, the nature of the interest in the audit information (as was discussed under Decision Path 2).

Requests received before the preparation of the draft report

Formally, request for audit reports at this stage in the audit process may be denied on the basis that the record does not exist as per subsection 10(1) of the Act. Informally, however, the audit officer may decide to accommodate the applicant's request beyond the strict requirements of the Act. The auditor may wish to indicate to the applicant that the requested report may be forwarded within a reasonable period subsequent to the completion of the audit field work. It is stressed once again that these informal discussions should be arranged through the departmental access co-ordinators.

The intent of the auditor in offering informally the completed audit report is to ensure that all requests for information are treated in a reasonable manner. To accomplish this, it is also necessary for the auditor to ensure that the report is completed and made available within an acceptable time frame. The following procedures are expected to achieve this purpose:

- auditee comments on a draft audit report will normally be received, and incorporated where necessary into a revised report, within a maximum two-month time period from the date the initial draft was completed; and
- the revised audit report will be made available to the applicant within this two-month period.

The OGC will continue to provide, through its performance assurance activity related to timeliness of audit reporting, an assessment of the reasonableness of the time frame between the end of audit field work and completion of an initial draft report.

Regardless of the reasonableness of the two-month time period considered necessary to provide a quality audit report, the audit officer may be required in certain circumstances to furnish the report to the applicant in less time. The applicant may not accept the auditor's informal offering of the draft report within the time frame discussed above. Instead, the applicant may choose to submit a second formal request for information at a later point in time when the report is in the process of being prepared by the auditor or being reviewed by the auditee. In such cases, as will be discussed later in this scenario, the audit will be required to disclose the report, as it exists, to the applicant within 30 days.

When a request is received prior to the preparation of the draft report and the applicant's interest is directed towards obtaining working paper information, the auditor should review the requested information according to the provisions of the Act (particular attention should be paid to sections 16, 19, 21 and 22). This is similar to the method discussed under Decision Path 2. The major distinction in this scenario, however, is that the likelihood of injury to the internal decision-making processes, and to the auditee, may be greater owing to the timing of the request. Because the auditor's deliberations are incomplete, the risk of harmful effects from disclosure may be greater. While the use of exemptions in this case should not be automatic, the auditor may technically have a more sound basis for invoking certain provisions to protect the audit decision-making (consultative and deliberative) process. In particular, use of section 21(1)(b) for certain interview notes, minutes of meetings or other accounts of consultations and deliberations may be appropriate should disclosure of such information inhibit the frank exchange of views among officials and thereby hinder the completion of the audit process.

Request received while the draft report is being prepared by the auditor or being reviewed by the auditee

When a request for an audit report is received at this point in time, the audit is required by the provisions of the Act to disclose the record to the applicant within 30 days. Because the draft audit report represents a crucial aspect of the auditor's deliberations in arriving at an assessment, particular care is required in ensuring that disclosure at this point in the audit does not harm the decision-making processes which are as yet incomplete. Review of the Act suggests that the audit process is particularly vulnerable to injury should requests be received at this point in the audit. Certain exemptions noted below, may apply to portions of the content of draft reports but the protection available is not considered to fully remove the risk of injury to the integrity of the audit process.

The following exemptions may be important should requests for audit reports be received prior to their review by the auditee. Use of paragraph 21(1)(a) may be appropriate for protecting advice and recommendations contained in the draft report if the auditor determines that disclosure of this information will cause injury or harm to the particular internal processes to which it relates. Paragraph 21(1)(b) may be applied to protect accounts of consultations or deliberations relating to the contents of draft reports if disclosure is injurious, but the actual contents of the report itself probably cannot be withheld using this exemption. Finally, if the auditor firmly believes that it is clearly necessary and reasonable to have more than the critical 30 days for providing access to draft audit reports, the Act allows a time extension

per subsection 9(1). This subsection allows extension of the initial 30-day period if consultation is necessary and cannot be completed within this time period. At present, however, use of this provision is considered very tentative and not generally recommended, particularly given its very limiting interpretation in the Interim Policy Guide issued by TBS.

For audit groups that employ private-sector consultants to perform audit activities, the use of the exemptions noted above is limited. Paragraph 21(2)(b) provides that subsection 21(1) does not apply in respect of a record that contains a report prepared by a consultant or advisor who was not, at the time a report was prepared, an officer or employee of a government institution or a member of the staff of a Minister of the Crown. It is likely that the use of the term "report" in the Act will not be applied literally but will extend to all records under the control of the government institution prepared by the consultant. As has been suggested by this paper, however, the limited usage of subsection 21(1) by the internal audit community will not likely create a significant distinction between the degree of disclosure required for the contents of records prepared by consultants versus government auditors. Nevertheless, should a request for information prepared by consultants be received prior to the completion of the audit, there may be increased need on the part of consultants to expedite verification of the accuracy of records requested within the 30-day period allowed for responding to access requests.

When an incomplete or unsubstantiated draft audit report must be released, the auditor may wish to provide additional information to the applicant clarifying the basis, and any related reservations, upon which the contents have been derived to this point in the audit. The auditor may also wish to identify on the draft report disclaimers with respect to the accuracy of representations provided. The best protection to the deliberative aspect of the audit process, however, is to ensure that, prior to the preparation of draft reports, auditors carefully determine and confirm the accuracy of their observations through continual dialogue with the auditee. The importance of the Standard 22 of the Standards for Internal Audit in the Government of Canada, which relates to the discussion of audit findings and recommendations with the officials responsible for the activities being commented upon, becomes increasingly significant given the broader potential readership of audit records.

Request received subsequent to auditee review and verification of the draft report

Receipt of a request for information at this point in time is normally not considered problematic to auditors. The deliberative process is considered essentially complete and the likelihood of injury as a result of disclosure of audit information is significantly lessened. As such, the auditor should treat such requests in the manner described under Decision Path 1.

One final reminder is that any contact with applicants should be fully documented. Aside from the desirability of keeping track of the nature and timing of requests for administrative purposes, such information will be useful as input to possible future revisions of this document, or even the Act and/or its associated Treasury Board Policy. It will also, of course, be useful should there be any subsequent intervention by the Information Commissioner or legal action.

DISPOSITION

The internal audit community is invited to provide comment to IASSD on the contents of this notice. Monitoring of experiences with the Act and review of the procedures adopted to deal with requests for audit information will be performed as part of the performance assurance review program of IASSD.

REFERENCES

Federal Government Reference Documents (formal)

- Circular No.: 1983-35, Interim Policy Guide, Access to Information Act and the Privacy Act, Treasury Board Secretariat; June 1, 1983.
- Bill C-43, as passed by the House of Commons; June 28, 1982.
- Standards for Internal Audit in the Government of Canada, Office of the Comptroller General, Policy Development Branch, Treasury Board, 1982.

Departmental Internal Audit Reference Documents (informal)

- Office of the Comptroller General, Policy Development Branch, Internal Audit and Special Studies Division, Policy Interpretation Notice 83-02: "Audit Working Papers".

The Working Paper File as the Documented Record
of a Decision-making Process

The Working Paper File is a documented record of the internal audit assignment's field work phase. Table 1 below, illustrates the audit process as a decision-making process and identifies the nature of the auditor's deliberations:

The purpose in drawing a parallel between the audit process and a decision-making process is twofold. The first, is to demonstrate that the audit process, a particular type of decision-making process, has the same consultative and deliberative content as any decision-making process which, therefore, is at least technically subject to exemption per paragraph 21(1)(b), given that injury due to disclosure of that particular content can be demonstrated. The second, is to provide a framework within which it is possible to distinguish the approach to be taken to treatment of requests for information (see discussion of Decision Paths 1, 2 and 3).

Table I
Decision-Making

Process Stage	Process Elements		
	Generic Decision-Making	Field Work	Working Papers
1. Problem Identification	- Identification of problems/opportunities/constraints, values, relevance criteria	- Assignment planning: (Identification of scope, suspected weaknesses, lines of inquiry, objectives)	- Assignment Plan
2. Problem Specification	- Specification of the problem in terms of its nature, structure, variables, parameters constraints and objectives/success criteria	- Review phase: describing the auditee environment; development of pre-determined control model (success criteria); preliminary testing to localize problem/opportunity areas and constraints and verification	- Detailed description flow charts, data predetermined control model; list of weaknesses
3. Alternative Development	- Enumerate and develop alternative solutions (a form of hypothesis testing); choose best solution	- Evaluation Phase: confirm problems; perform cause/effect analysis; consolidate conclusions	- Documented analysis findings, tests, conclusions
4. Choice			
5. Report	- Confirm and document the results of the decision	- Develop conclusions and overall opinions	- Draft and final reports

Essentially, the issue is that disclosure of internal audit record content during the decision-making process is more liable to be injurious, to both auditee and the audit function than after the decision-making process is completed. In the future, a "Letter of Representation" procedure used by private sector accounting firms, may be a useful means of further clarifying the point at which the audit decision-making (consultative/deliberative) process is complete.



Comptroller General
of Canada

Contrôleur général
du Canada

Ottawa, Canada
K1A 1E4

No. 1984-03
Date: 10-10-84

Internal Audit
Policy Interpretation Notice

Subject: PRE-IMPLEMENTATION AUDIT

Office of the Comptroller General

Policy Development Branch
Internal Audit and Special
Studies Division

PURPOSE AND SCOPE

Modern internal auditing, as defined in the Standards¹, has two main thrusts, namely: (1) helping managers achieve improved productivity (auditing economy, efficiency and effectiveness) of their ongoing operations; and (2) advising management on the development of economic, efficient and effective major, new, or changed infrastructure (pre-implementation auditing).

The purpose of this Policy Interpretation Notice (PIN) is to provide the internal audit community with guidance related to pre-implementation audit. It supplements standard No. 2, dealing with "scope" and the associated discussions in Chapter Two, Scope and Frequency, and Appendix A, Auditing Computer-Based Systems.

ISSUES

1. What is a pre-implementation audit?

A pre-implementation audit is an audit carried out on departmental/agency systems during the design/development and installation process rather than after the system has been turned over to the client for operation.

2. What is the scope of a pre-implementation audit?

To be consistent with the Standards, the scope of pre-implementation audits should include all major new systems under development, including: new legislation, policies and procedures, information systems (both EDP and non-EDP) and production processes.

¹ See Standards for Internal Audit in the Government of Canada.

Questions concerning this notice should be directed to:

INTERNAL AUDIT AND SPECIAL STUDIES DIVISION
POLICY DEVELOPMENT BRANCH
OFFICE OF THE COMPTROLLER GENERAL
(613) 996-6171 or 995-1297

Pre-implementation audit consists of two possible components:

- (i) Audit of the project management/system development process (for EDP systems, this includes the complete systems development life cycle²), and
- (ii) Audit of the control framework being designed for the system.

3. Why do a pre-implementation audit?

The rationale for initiating pre-implementation auditing is that it is more cost-effective to correct weaknesses in the control framework during the design/development and installation process than after implementation, when large quantities of resources have been expended and strong commitment to the entity under design has been generated.

This does not eliminate the need for post-implementation audits as there is no assurance that what was designed and installed was maintained or operated as intended, and that the original requirements continue to hold true.

4. How far can the auditor go without impairing independence?

Auditors always have the problem of possibly compromising their objectivity through their efforts to gain an understanding of, and empathy with, the auditee's situation. This is particularly true for pre-implementation auditing. For example, there is a real danger that the auditor will get co-opted into participation in actual design of controls rather than playing the "advice" role. Even in playing this more restricted role the auditor may become too committed to the resultant systems configuration to be totally unbiased in later, post-implementation audits of that same system.

It is considered however, that the benefits of such auditing far outweigh the risk incurred and that, in any case, it is possible to minimize the danger of loss of objectivity by judicious control of the nature and scope of the auditor's involvement, and by adopting an appropriate assignment strategy.

A more extensive discussion of the above issues is presented in the attached Discussion Paper.

2

See the Administrative Policy Manual, Chapter 440.

INTERPRETATION NOTICE POSITION

The position of this PIN is that: Pre-implementation audits should be undertaken for all major systems under development in departments and agencies; they should be reflected in the departmental/agency internal audit policies and plans; and, the potential loss of auditors' objectivity can be minimized through appropriate terms of reference and assignment strategy.

DISPOSITION

It is our intention to adopt one or more of the following actions, based on the nature of the feedback received from the internal audit community:

1. Prepare a chapter on pre-implementation auditing for Volume II of the IACIA Internal Audit Handbook (IAH).
2. Prepare a guide on pre-implementation auditing for Volume III of the IAH.
3. Integrate pre-implementation audit guidance into existing IAH chapters.
4. Prepare changes to the relevant portions of the Standards for their next revision.

The internal audit community is invited to provide comments to IA&SSD on the attached Discussion Paper with the view to influencing the content and location of future guidance on this important subject.

Attachment to
PIN 1984-03

PRE-IMPLEMENTATION AUDIT

A Discussion Paper
in support of PIN 1984-03

Policy Development Branch
Internal Audit and
Special Studies Division

DISCUSSION PAPER

PRE-IMPLEMENTATION AUDIT

Subject: Participation of Internal Auditors in Systems Under Development

Introduction

The purpose of this Paper is to explore various aspects of participation by auditors in systems under development. This type of participation will be termed "pre-implementation audit".

The subject of pre-implementation audit will be discussed from the point of view of its background, definition, scope, purpose, effect on other aspects of the audit function and possible means of implementation.

Background

There are several factors which have the effect of increasing pressure on internal auditors to participate in systems development projects: systems development projects are notorious for cost/time overruns; implemented systems are equally notorious for not meeting all user requirements; systems, particularly EDP systems, often have under-designed control frameworks; and, recent cost-cutting programs, prompted by a recessionary economy and large deficits, have focussed increased attention on improving the productivity/efficiency of all processes. This puts the spotlight particularly on the systems development process because of the costly down-stream effects of inadequate design and implementation.

Audit literature has recognized the potentially useful role of pre-implementation audit for some time, however, it has been almost exclusively centred on EDP information systems. This view of systems has two limitations: not all systems are "information" systems and EDP is only one possible vehicle for implementing systems. In what follows, we will employ a broader view of systems¹.

Our recognition of the desirability of pre-implementation audit is reflected in the Standards² in several ways:

- (i) Standard 2., Scope, states that "The scope of internal audit shall encompass all aspects of a department's operations. The internal auditor assesses and expresses an opinion upon:
 - a) The design, development, implementation ... of all systems, procedures, processes and controls, including computer-based systems; ...";
-
1. A system is defined as a set of elements related to one another according to some coherent pattern. While the elements are important, it is the linkages or relationships among the elements, defined in terms of common purpose, which make it possible to speak of a system - abstracted from Managing Public Systems: Analytic Techniques for Public Administration, by Michael J. White, Clayton Ross, Robert Myrtle, Gilbert Siegel and Aaron Rose.
 2. Standards for Internal Audit in the Government of Canada.

- (ii) Standard 3., Frequency, adds that "All major systems, ... performing significant responsibilities should be examined within a period not exceeding three to five years..."; and,
- (iii) In the elaboration of standards 2. and 3., in Chapter Two, it is made clear that pre-implementation audit was intended to include new legislation, agreements and contracts.

Definition

As indicated above, we will term the auditor's participation in systems under development "pre-implementation audit" and will adopt the broadest definition of the term "system", a definition which encompasses all major infrastructural mechanisms in an organization, including: legislation, policies and procedures; information systems (EDP or other); production systems/processes; agreements and contracts; and organization structures. See Figure 1 for an illustration of typical infrastructural hierarchy and the relationships.

Scope and Purpose of Pre-Implementation Auditing

The scope of a pre-implementation audit has two components. The first has to do with the entities subject to pre-implementation audit - these have already been defined above as all major new systems (i.e. infrastructural hierarchy). and should include major re-designs of existing systems.

The second component of scope has to do with the type of auditor participation that could be contemplated. These are:

- (i) Audit of the project management/systems development process.
- (ii) Audit of the control framework that is being designed in conjunction with (surrounding), or as an integral part of the system under design.

The first type of audit is aimed at assuring management that the development process adheres to prescribed (e.g. central agency) or generally accepted policies and practices, which ensure that sound systems are conceived, developed and implemented and that the development process is economic, efficient and effective. The second type of audit assures management that adequate operating and management controls are being conceived, developed and implemented, which in turn will ensure that the operators, managers and users of a system will have a means of determining whether the system is performing as intended.

For both types of audit the rationale employed is twofold. The first is that it is easier and less costly to ensure adequate design at its conception than to rely on remedial changes after implementation. The second is that systems that will be used repeatedly must be more carefully designed and managed at the front end because of the potentially negative effects on operating efficiency and effectiveness that could result from a poor design/development process.

A derivative benefit from pre-implementation audits is the resultant heightened awareness of the role of control accruing to all participants (managers, users, systems designers, etc.).

Infrastructural Hierarchy

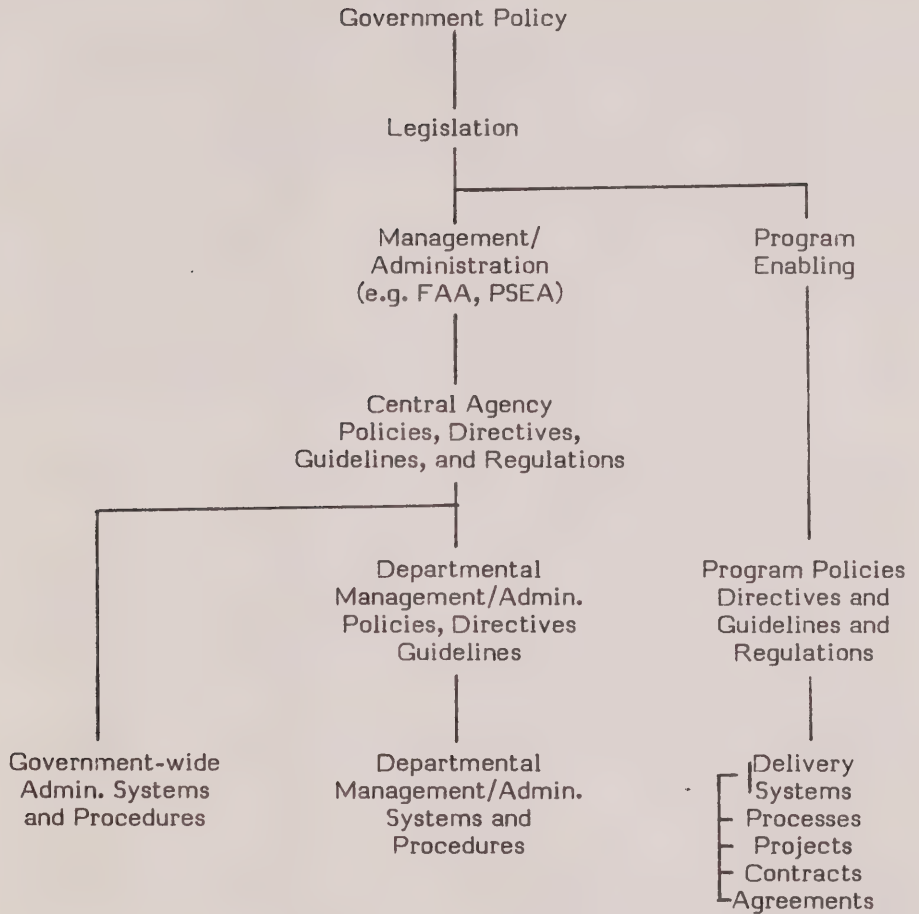


Figure 1

The Effect of Pre-implementation Audit on Other Aspects of the Audit Function

There are two aspects to consider. One is the effect on other types of audit and the other is the effect on the audit function's independence.

A pre-implementation audit should reduce the number of systems-oriented findings that the audit group is likely to identify in future periods, however, it is unlikely to eliminate them. There are three reasons for this: It is unlikely that any design will be perfect to start with; even if a design is perfect, it is unlikely that it will be implemented, maintained and operated exactly as designed; and finally, it is unlikely that the original environmental conditions or requirements will continue to hold true over the entire life of the system.

Independence is a difficult aspect to deal with as it is very subjective. Various auditors and managers will have differing views as to what independence is and when it is jeopardized. Guidelines which may prove useful in this context follow:

- (a) Avoid participation in actual design work (this parallels the traditional admonishment that auditors not participate in operations that they will be expected to audit in the future).
- (b) Specify the need for "key controls" but not what form they should take (i.e. specify the "what" and not the "how").
- (c) Negotiate the groundrules for participation ahead of time such that all parties understand and agree on their respective roles - independence and objectivity as an intent can be spelled out at that time (for example, specify that user managers should provide control objectives, systems designers should design the controls, and auditors should advise on the adequacy of controls).
- (d) Ensure that the auditor who participates in the pre-implementation audit is not the one who performs future post-implementation audits on the same system.

Although the potential for loss of objectivity in performing audits cannot be eliminated completely, it can be limited. Judicious control of the degree of auditor involvement in pre-implementation audits can minimize both the existence and appearance of such loss of objectivity.

Possible Means of Implementation

To start with, it is assumed that all departmental/agency internal audit policies and plans appropriately reflect provisions for pre-implementation audit in accordance with the Standards.

Other prerequisites to successful implementation of such audits would include: a requirement (in departmental/agency policies or directives) that managers notify the head of internal audit of all major systems development projects (this does not preclude the internal audit group performing its own surveillance through review of plans and other relevant documentation and through personal contact with managers); a requirement that managers/project leaders invite the internal audit group to participate in all major systems development activity (including participation in systems development teams, systems development Steering

Committees, etc.); active support of senior management for such participation, and, the acquisition of a sufficient number of appropriately qualified senior auditors who would lend credibility to the systems and to the internal audit function by their participation (contracting is an alternative, where resource budgets permit).

Although a comprehensive guide to pre-implementation auditing is beyond the scope of this Paper, some suggestions are presented for your consideration:

- (1) Although it is desirable that the auditor have a background in the subject-matter area of the proposed system (e.g. finance, personnel, specific program/activity) and in the technology expected to be used in the design of the delivery vehicle (e.g. EDP, micrographics) it should be kept in mind that the internal auditor's role is that of control not subject-matter expert.
- (2) It should be kept in mind that the main difference between pre-implementation and post-implementation auditing is one of timing. Therefore the methods and techniques used do not change appreciably.

For example, for the audit of the systems development process the relevant criteria would include those provided for project management, contracting and EDP systems in the Administrative Policy Manual and in the Guide on Financial Administration for Departments and Agencies. Also, relevant IACIA Guides (e.g. EDP Audit) are equally usable for pre-implementation auditing.

In the case of pre-implementation audit of the control framework being designed into or around the system under development, the starting point would be a pre-determined, normative control model, as it is for any audit, except that in this case there would be only a paper representation of an actual control framework to compare it with, rather than the physical one that would exist in the case of a post-implementation audit of the system.

- (3) In performing pre-implementation audits two key principles need to be kept in mind:
 - (i) Every system has to have the means whereby the operator and manager of that system can determine whether it is performing as intended, i.e. it must have controls.
 - (ii) Where the auditor is involved in the pre-implementation audit of only one element of the infrastructural framework (see Figure 1) the auditor has to be very aware of its relative position and role in the hierarchy. It is unreasonable to expect the same degree of specificity/precision in the specification of objectives, criteria, etc., and associated controls at each level. For example, at the highest level (legislation), the designers should not be expected to incorporate detailed implementation procedures and performance criteria as would be expected at the systems and procedures level. What one would expect is progressive elaboration as one moves down the hierarchy, and consistency and continuity between levels.

In general, when an auditor is involved in a pre-implementation audit at an intermediate level in the hierarchy, it is important for that auditor to become familiar with the role of adjacent (higher, lower and peer level) elements in the structure in order to be able to judge consistency and continuity.

- (4) The auditors assigned to pre-implementation audits should be those senior auditors in the group with the highest level of relevant expertise. This is due to the crucial nature (downstream impact) of the entity under audit.
- (5) The timing of the start of the auditor's participation should coincide, ideally, with the start of the formation of the development team, and certainly no later than coincident with the statement of the user's requirements.
- (6) The auditors participation in a pre-implementation audit is unlikely to be full-time but rather at key points in the development process (e.g. at, or just prior to: turnover of user specifications to the systems designer, turnover of the systems design to the programmer/procedure writer, system testing and cut-over/user acceptance). This type of on-off participation may aggravate the audits manager's resource allocation process, however, close collaboration with the systems development project leader can minimize the problem.
- (7) The timing of the first post-implementation audit of a new system, or major change, should be no sooner than six months after its turnover to the user/operator, i.e. after it has progressed from transient to reasonably steady state.

Conclusions

Pre-implementation audit is a valuable managerial aid. This has been recognized in the literature on auditing and reflected in the Standards.

This type of auditing applies to all major infrastructural mechanisms (systems) under development. It encompasses two distinct activities, i.e. audit of the development process and audit of the control framework being designed.

Pre-implementation auditing methods and techniques do not differ radically from normal, post-implementation auditing. However, the skill of the auditor applying those methods and techniques must be of the highest order because of the downstream impact of such an activity.

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